2006 ANNUAL REPORT

HYDRO
THE POWER OF COMMITMENT

SAFETY

"Safety is always on the top of my mind at work and at home. Not only my safety, but also the safety of my co-workers and my family. It's clear that Hydro is committed to ensuring that every employee is safe, every day."

Noah Smith
Line Worker, St. Anthony

ENVIRONMENT

"Hydro has a responsibility to protect the environment. We're focused on making improvements in the operation of our plant to minimize the potential impact on the environment."

Greg Mackey
Chemical Technologist,
Holyrood Generation Station

FINANCE & GOVERNANCE

"We are developing rigorous processes to evaluate potential investments and ensure they provide an appropriate financial return and support our growth strategy."

Rob Hull
Manager, Investment Evaluation,
Finance

GROWTH

"I'm excited about the work that Hydro is doing to pursue new business opportunities in the energy sector. Our team is focused on ensuring we achieve the maximum benefit from our province's energy resources."

Nancy Hart
Business Development Engineer,
Business Development

OPERATIONAL EXCELLENCE

"Core to our operations is a drive for operational excellence. Every day we think about the quality, reliability and service we provide to all electricity consumers."

Trevor Arbuckle
Manager, Hydro Generation

LOWER CHURCHILL

"It's an exciting time to be a part of the Lower Churchill Project. The project team is committed to achieving sanction for this monumental development that will result in a renewable and reliable energy supply."

Julia Hiscock
Scheduling and Planning Engineer,
Lower Churchill Project

PEOPLE

"Our employees are committed to excellence in their work and Hydro is committed to providing a great working environment. We're investing in our future by recruiting and retaining the very best talent."

Gerard McDonald
Vice President Human Resources
and Organizational Effectiveness

COMMUNITY

"I'm proud of the work that Hydro is doing in the community. I believe it's very important for the company and employees to support our communities and charities."

Pat Thornhill
Customer Service Representative

KEY FINANCIAL AND OPERATING HIGHLIGHTS

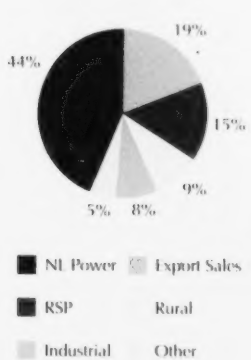
FINANCIAL HIGHLIGHTS

Years ended December 31 (millions of dollars)	**2006**	2005	2004
Revenues	548.0	532.5	493.5
Net income	70.0	71.9	67.2
Capital assets, net	1,791.5	1,781.6	1,784.5
Long-term debt	1,378.4	1,174.8	1,407.6
Shareholder's equity	574.4	507.0	490.9
Dividends	2.6	55.8	50.6
Debt to capital	70%	74%	76%
Return on capital employed	8.7%	8.8%	8.3%

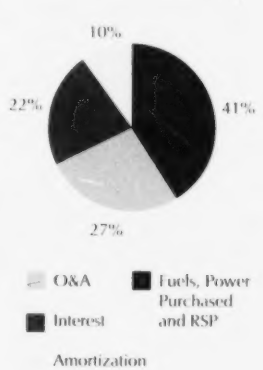
OPERATING HIGHLIGHTS

Years ended December 31	**2006**	2005	2004
Number of customers	35,381	35,343	35,241
Installed generating capacity (MW)			
Hydroelectric	6,592	6,592	6,592
Thermal	640	640	640
Diesel	56	56	57
Energy sales (GWh)			
Newfoundland and Labrador	8,397	6,011	8,905
Export	31,318	30,170	29,786
Transmission lines (km)	4,781	4,781	4,736
Peak demand (MW)	6,897	6,969	7,050

2006 Revenue
Total Revenue: $548.0 million

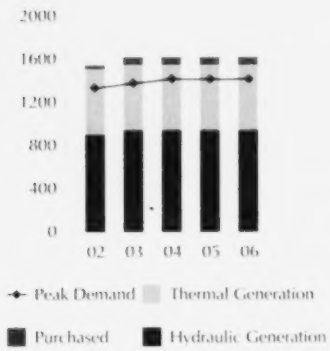


2006 Expense
Total Expense: $478.0 million



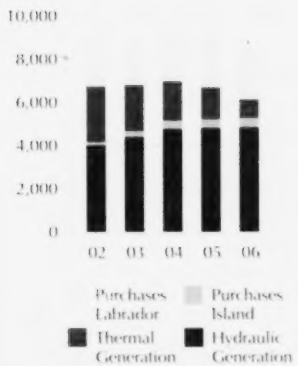
Island Interconnected System Gross Generating Capacity and Peak Demand

Megawatts (MW)



Interconnected Systems Gross Energy Generated and Purchased

Gigawatt Hours (GWh)



Interconnected Systems Energy Sales

Gigawatt Hours (GWh)

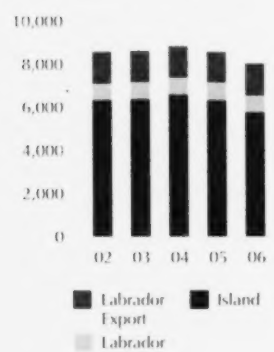


TABLE OF CONTENTS

Message from the Chair 1
Message from the CEO 2
Corporate Overview 4
2006 Performance Review 6
Management's Discussion and Analysis 22
Management Report 46
Auditors' Report 47
Financial Statements 48
Financial Statistics 74
Operating Statistics 75
Executive Leadership Team 76
Officers 77
Board of Directors 78
Corporate Governance 80
2006 Installed Generating Capacity / System Map 81

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MESSAGE FROM THE CHAIR

Newfoundland and Labrador Hydro's progress in 2006 generated great momentum towards the company's new direction. We rounded out the company's leadership team early in the year and followed with a thorough corporate planning process that focused the company around eight long-term corporate goals and laid a foundation for future growth.

During 2006, the Board of Directors concentrated on aligning its governance practices with Hydro's planned evolution. We have been working closely with our Shareholder, the Government of Newfoundland and Labrador, on the development of the provincial energy plan and Hydro's future role and expectations.

Our Shareholder, through its actions, has renewed its commitment to retain ownership of the company and in 2006 made an important decision to reinvest dividends in the company. This investment demonstrates the level of confidence in the company and the shared vision we have for energy development in Newfoundland and Labrador.

The next few years will be exciting for Hydro, but not without its challenges and risks; and the Board is committed to providing sound governance, direction and leadership. During the past year, the Board established a Corporate Governance Committee and began a comprehensive governance review with the objective to identify and implement best-practise corporate governance policies and processes. This type of evolution is consistent with many leading Crown corporations across Canada. Our goal is to grow this company into a respected leader in the energy sector and one of the first steps is strong governance.

Safety is also paramount for the Board. Last year, we broadened the focus of the Environment Committee to also provide oversight on safety and health. As a company in the energy business, safety performance is one of our key performance indicators and the Board is committed to safety excellence.

This year's annual report highlights progress on our corporate goals and demonstrates that Hydro is gaining the momentum required to grow the business and pursue new opportunities.

I thank my past and present colleagues on the Board for their support and contribution towards these achievements. Looking into the future, the Board will continue to provide oversight and ensure Hydro realizes its full potential.

Dean MacDonald
Chair, Board of Directors

MESSAGE FROM THE CEO

This has been a rewarding year for Hydro. We developed a corporate strategy for the company that sets the stage for performance and will guide our direction for the next five years. The plan is exciting and our targets are challenging yet achievable. It will enable us to leverage our strengths to grow our business for Newfoundland and Labrador.

PERFORMANCE IS OUR FOCUS

We take pride in many accomplishments across the company in 2006. We achieved our targets on six of our eight corporate performance goals. Of particular note was our reduction in emissions at the Holyrood Thermal Generating Station.

We achieved a five-month average guaranteed winter availability performance for the Churchill Falls Generating Station of 99.5 per cent; and improved our reliability performance for our largest domestic customer – Newfoundland Power.

SAFETY IS OUR PRIORITY

Hydro's safety performance was average compared to our peer utilities and was clearly not adequate for a leading energy company. As CEO, my responsibility is to lead the company towards achieving a best in class safety performance.

Our employees value safety and they play an important role in our safety performance. We saw successes like the renewal of the Corporate Safety Advisory Committee with representation from the International Brotherhood of Electrical Workers (IBEW), and safety leadership training for key leaders across the business. We also developed a strategy for achieving zero incidents that included a new safe workplace observation reporting system.

We are now clearly focused on safety; however, our safety performance was an area of mixed results in 2006. On a positive note, we had an increase in the number of near miss incident reports compared to 2005, and we built awareness of the importance of workplace safety and leadership commitment. We also achieved a reduction in the number of days lost due to disabling injuries. However, we were challenged by an increase in the number of workplace incidents compared to the previous two years. Our approach to safety will continue to be relentless.

GROWING OUR BUSINESS

We had several key wins this year in the area of business growth. We have a plan in place moving us into other energy sectors including; oil and gas; wind energy; alternative energies; and, research and development. This province is truly an energy warehouse and we have been evaluating a number of oil and gas opportunities. We will move forward on those business ventures which drive value and growth and have the right mix of risk and reward. The company awarded contracts for two wind projects on the island and also

"We will move forward on those business ventures which drive value and growth and have the right mix of risk and reward."

began monitoring the Labrador wind resource. We also announced a new research and development project, a wind-hydrogen-diesel integration, in Ramea.

We also advanced the Lower Churchill Project on a number of fronts. We are moving firmly towards sanction in 2009. We made applications for access into a number of markets: Ontario, Quebec, New Brunswick and the northeast United States. We also filed our environmental registration in December and discussions with the Innu Nation, who have a recognized land claim in the project area, on an Impacts and Benefits Agreement are progressing well.

PEOPLE ARE THE CORE OF OUR SUCCESS

A dedicated group of talented men and women across Hydro are helping to build our province's energy future. They delivered on some remarkable achievements in 2006.

A key area of focus this year was strengthening our relationship with the IBEW. Their active involvement and contribution in our corporate planning process is one illustration of the important progress made in this area.

Hydro is committed to the development of our employees and in 2006 introduced the Leadership Fundamentals program, aimed at developing our front-line supervisors. We also introduced a new approach to succession planning to ensure we have qualified people ready to perform in key roles in the coming years.

DELIVERING FOR OUR CUSTOMERS

We recognize that our customers are concerned about the rising cost of electricity. In December, Hydro filed an amended General Rate Application with the Newfoundland and Labrador Board of Commissioners of Public Utilities for 2007 electricity rates. Through a successful negotiation process with interveners and a contribution from the government, we virtually eliminated an increase for residential and commercial customers and large industrial customers will see a rate decrease. Our direct residential customer satisfaction also remained high with 92 per cent telling us they were satisfied with our service.

Hydro is this province's newest energy company. We are building on our strong foundation as the largest electricity generator and I believe we are on the right path to position Hydro as a future leader in the energy sector. This company will play a key role in the growth and prosperity of the province.

Ed Martin
President and CEO

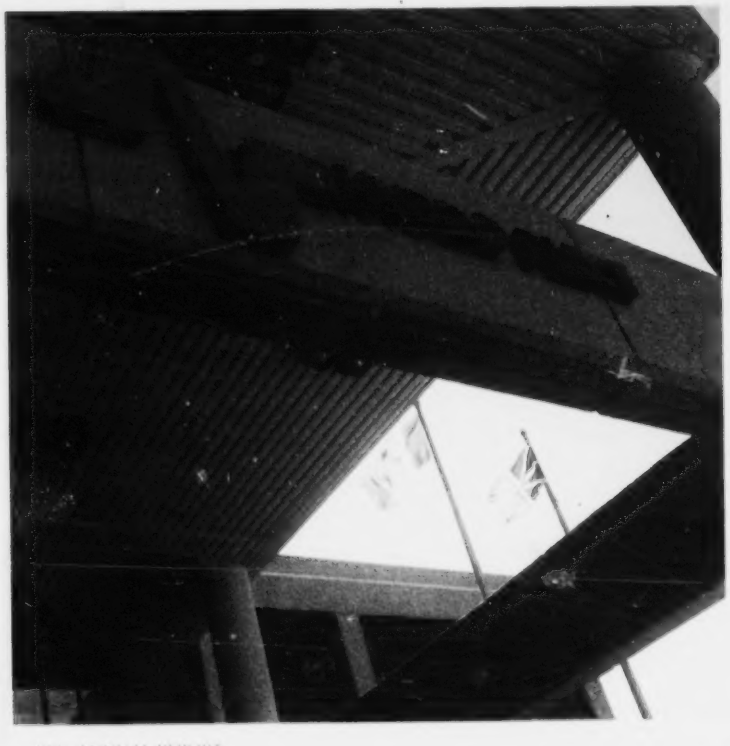
CORPORATE OVERVIEW

Hydro is a Crown corporation owned by the Province of Newfoundland and Labrador. Hydro is the parent company of Churchill Falls (Labrador) Corporation Limited, Lower Churchill Development Corporation Limited, Gull Island Power Company Limited and Twin Falls Power Corporation Limited.

Headquartered in St. John's, Hydro supplies over 80 per cent of the province's electrical energy, operates the second largest underground hydropower station in the world, and is expanding its operations into oil and gas, wind generation, and, research and development.

Hydro is the fourth largest power utility in Canada, with 7,288 megawatts (MW) of installed generating capacity, and is the province's main energy provider with electrical sales of 39,715 gigawatt hours (GWh) in 2006, 8,397 GWh for domestic use and 31,318 GWh for export.

The company has over 1,200 employees in four lines of business: Regulated Operations; Churchill Falls Operations; the Lower Churchill Project; and Business Development.



REGULATED OPERATIONS

Hydro is committed to operational excellence. This division's business is to deliver safe, reliable, least-cost power to industrial, utility and over 35,000 direct customers in rural Newfoundland and Labrador.

The assets include: nine hydroelectric generating stations; one oil-fired plant; four gas turbines; three interconnected diesel generating stations; and, 21 isolated diesel generating and distribution systems. Hydro also maintains 54 high-voltage terminal stations, 25 lower-voltage interconnected distribution substations, 3,742 km of interconnected high-voltage transmission lines and 3,334 km of distribution lines.

The division has over 860 employees dedicated to providing power to electricity consumers throughout the province and they remain focused on safety, environment, conservation and efficient operations.

CHURCHILL FALLS OPERATIONS

The Churchill Falls Generating Station, one of the largest underground powerhouses in the world, has 11 turbines with a rated capacity of 5,428 MW. In 2006, more than 34 terawatt hours of electricity was produced, with the majority of that energy sold to Hydro-Québec through a long-term power purchase contract set to expire in 2041. The remainder of the power is used for mining operations in Labrador West and for Hydro's Labrador Interconnected System.

The company ensures that the 220 men and women who operate the Churchill Falls Generating Station, as well as their families, live in a comfortable community with the expected amenities of any town. The community of Churchill Falls has a population of 650 people. The company operates the town, including: a school, hotel, theatre, library, bank, post office and recreational facilities.

Reinvesting in Churchill Falls to ensure that future generations will have the benefit of this resource is part of the long-term management plan.

LOWER CHURCHILL PROJECT

The lower Churchill resource is one of the highest value, undeveloped hydro resources in Canada and includes the development of two hydroelectric sites on the lower Churchill River – Gull Island (2,000 MW) and Muskrat Falls (824 MW).

Hydro is moving ahead with the necessary activities to achieve sanction in 2009 and deliver first power in 2015. These activities are focused in six key areas including: environmental assessment; Impacts and Benefits Agreement negotiations with the Labrador Innu; engineering; project execution planning; financing; and commercial arrangements and market access.

The Lower Churchill Project has the potential to generate significant financial benefits, in addition to being a made-in-Canada solution to the increasing demand for energy, and particularly, the need for clean, renewable energy. Combined with the Churchill Falls Generating Station, the three generation sites could produce the electrical energy equivalent of 225,000 barrels of oil a day – forever.

BUSINESS DEVELOPMENT

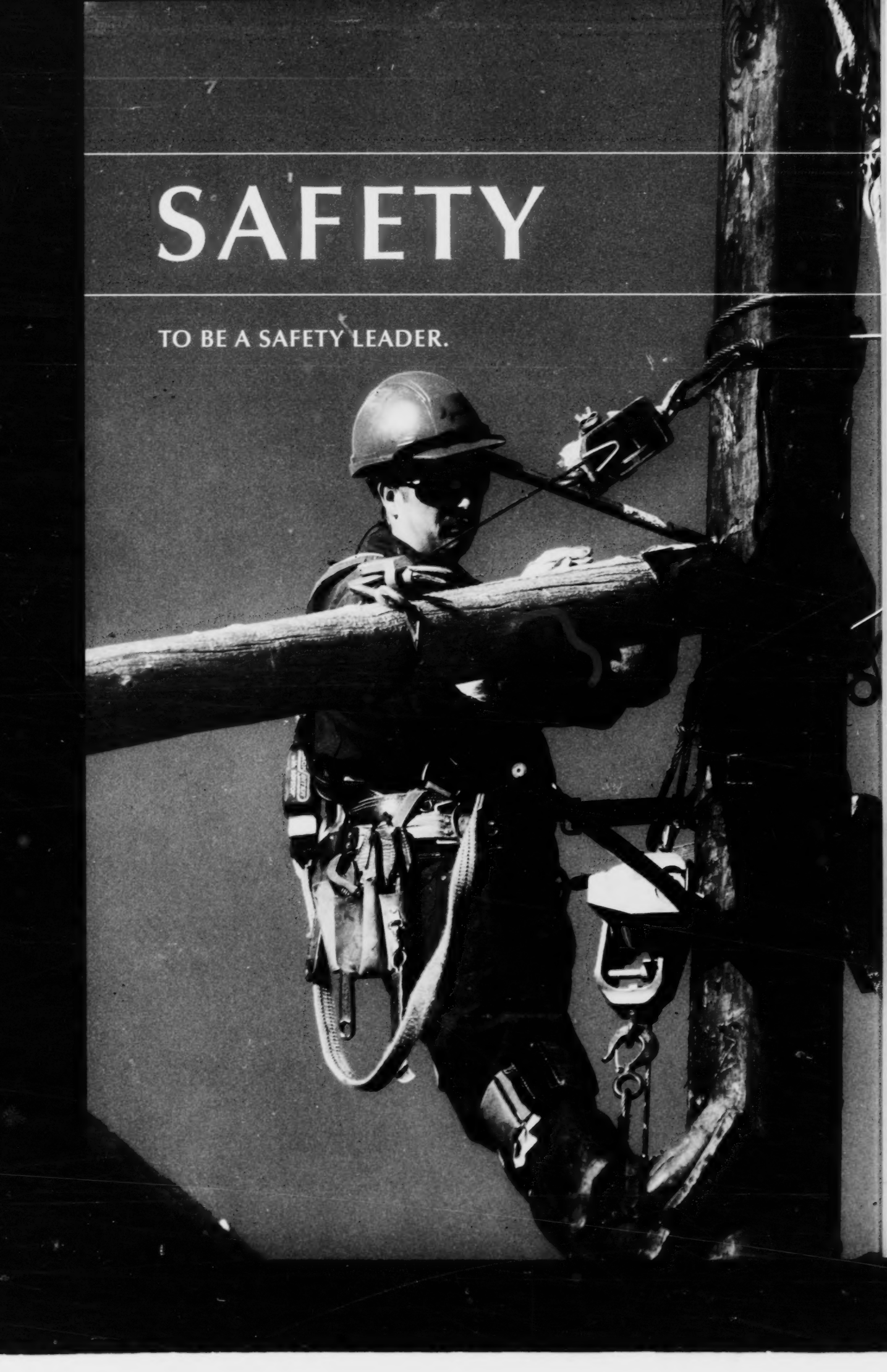
Hydro is pursuing business opportunities in oil and gas; wind generation; alternative energy sources; and, research and development.

Hydro's wind development strategy involves pursuing three distinct opportunities. On the island, Hydro awarded contracts for the development of 51 MW of wind power; in Labrador, Hydro is monitoring the wind resource to determine its potential; and in Ramea, a remote community on the South Coast of Newfoundland, Hydro has begun a five-year research and development project for an isolated wind-hydrogen-diesel generation solution.

Hydro is also exploring opportunities in the oil and gas sector with an approach to maximizing benefits from this resource to help build a stronger economy and support Hydro's pursuit of renewable resource developments.

SAFETY

TO BE A SAFETY LEADER.



PUTTING SAFETY FIRST

As a growing energy company and a successful power utility, safety is our number one priority. Our safety objective is to have zero workplace incidents.

In 2006, we brought a renewed focus to safety at Hydro. This year we exceeded our target for reporting incidents and near misses. Reporting is critical to preventing a major incident or fatality and achieving our safety targets. While we were successful in increasing safety reporting, the number of medical aid and disabling injuries increased by two over 2005 performance. Fortunately, the severity of injuries, as measured by days lost from work, decreased by 66% from 157 to 54 days lost.

Companies that achieve excellence in safety performance understand the importance of safety culture and behaviours. Hydro implemented a number of safety strategies, initiatives and programs aimed at changing behaviours and strengthening our safety culture to achieve our objectives. These included:

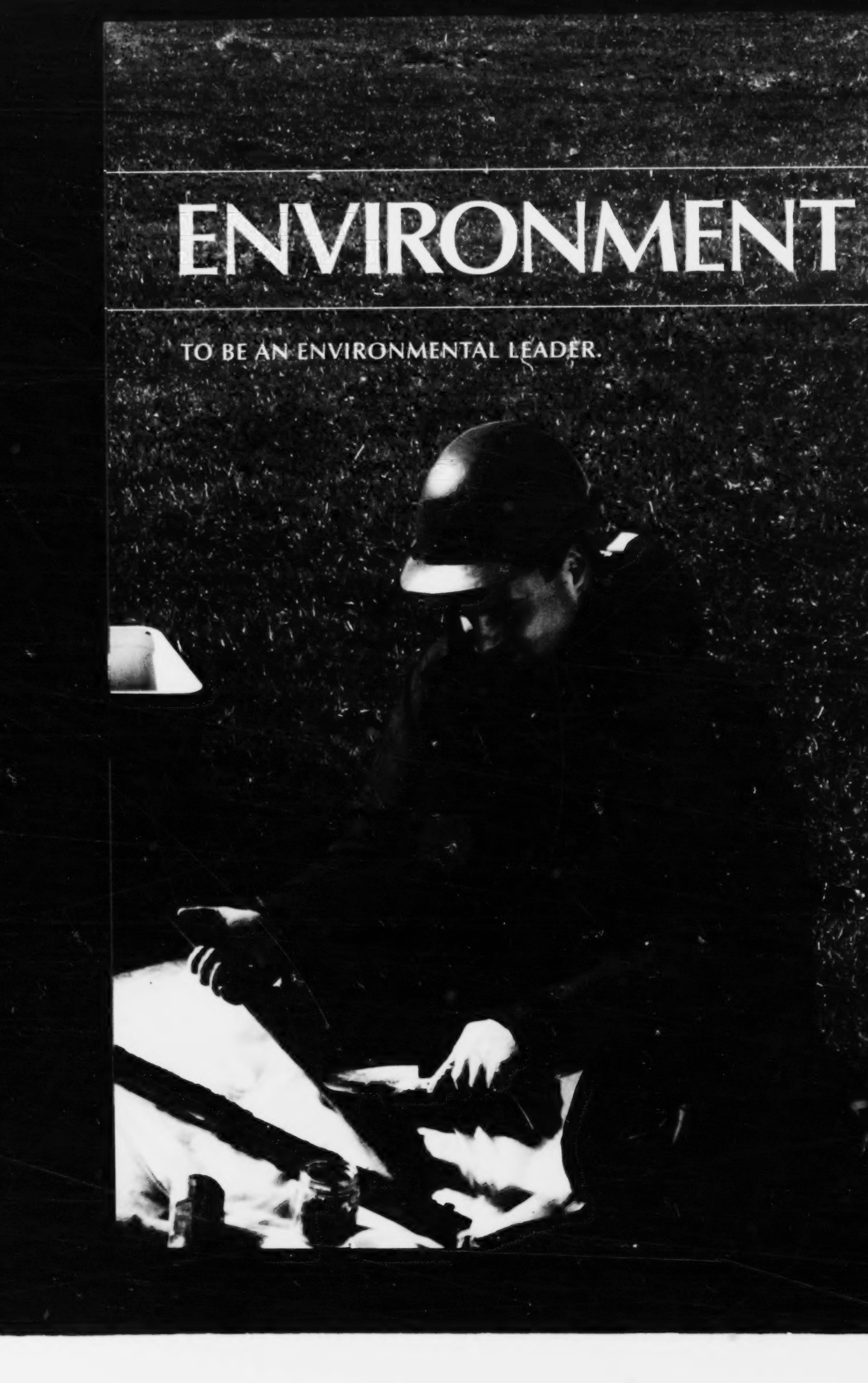
- Completing a thorough, corporate-wide safety strategy outlining a safety framework and specific initiatives and action plans.
- Implementing a new company-wide process for collecting and reporting hazards, near misses and safe work observations in the latter part of 2006. SWOP (Safe Workplace Observation Program) focuses on reporting safety observations to make the workplace safer by preventing major incidents.
- Adopting a new joint labour-management approach for our Corporate Safety Advisory Committee (CSAC). The committee has participation from the International Brotherhood of Electrical Workers (IBEW) and various levels of management. CSAC is an avenue to work collaboratively on safety concerns to achieve our shared objectives.
- The Leadership Team holding monthly safety meetings dedicated to reviewing safety performance and specific incidents and strategies for improvement.
- Hosting a Safety Summit with leadership, operational managers, supervisors and union representatives to focus on creating a safety culture.
- Training frontline supervisors, managers, Occupational Health and Safety Committee members and members of the IBEW executive board in safety leadership.

SWOP

Effective comprehensive reporting at all levels in the company is critical to preventing major or serious incidents. The Safe Workplace Observation Program (SWOP) makes reporting simpler for all employees, contractors, visitors and the public. Anyone can make a report and there are four types of observations: Commendations, Conditions, Near Miss Incidents and Loss Incidents. The concept behind SWOP is simple. See it. Fix it. Report it.

ENVIRONMENT

TO BE AN ENVIRONMENTAL LEADER.



REDUCING OUR ENVIRONMENTAL FOOTPRINT

Wind Generation

Newfoundland and Labrador has a world-class wind resource - a clean, renewable and stable source of energy for our province. Over the past year, Hydro has been looking closely at the development opportunities that exist to incorporate wind generation into its three main electricity systems. From monitoring in Labrador to the award of wind power contracts on the island and an innovative wind-hydrogen-diesel research and development project in the isolated community of Ramea, Hydro is committed to developing this valuable resource in a manner consistent with our business goals.

As the primary generator of electricity in the province and a committed member of the community, Hydro has a commitment and responsibility to protect the environment. Our commitment to environmental leadership can be seen across our business through our ISO 14001 certified Environmental Management System.

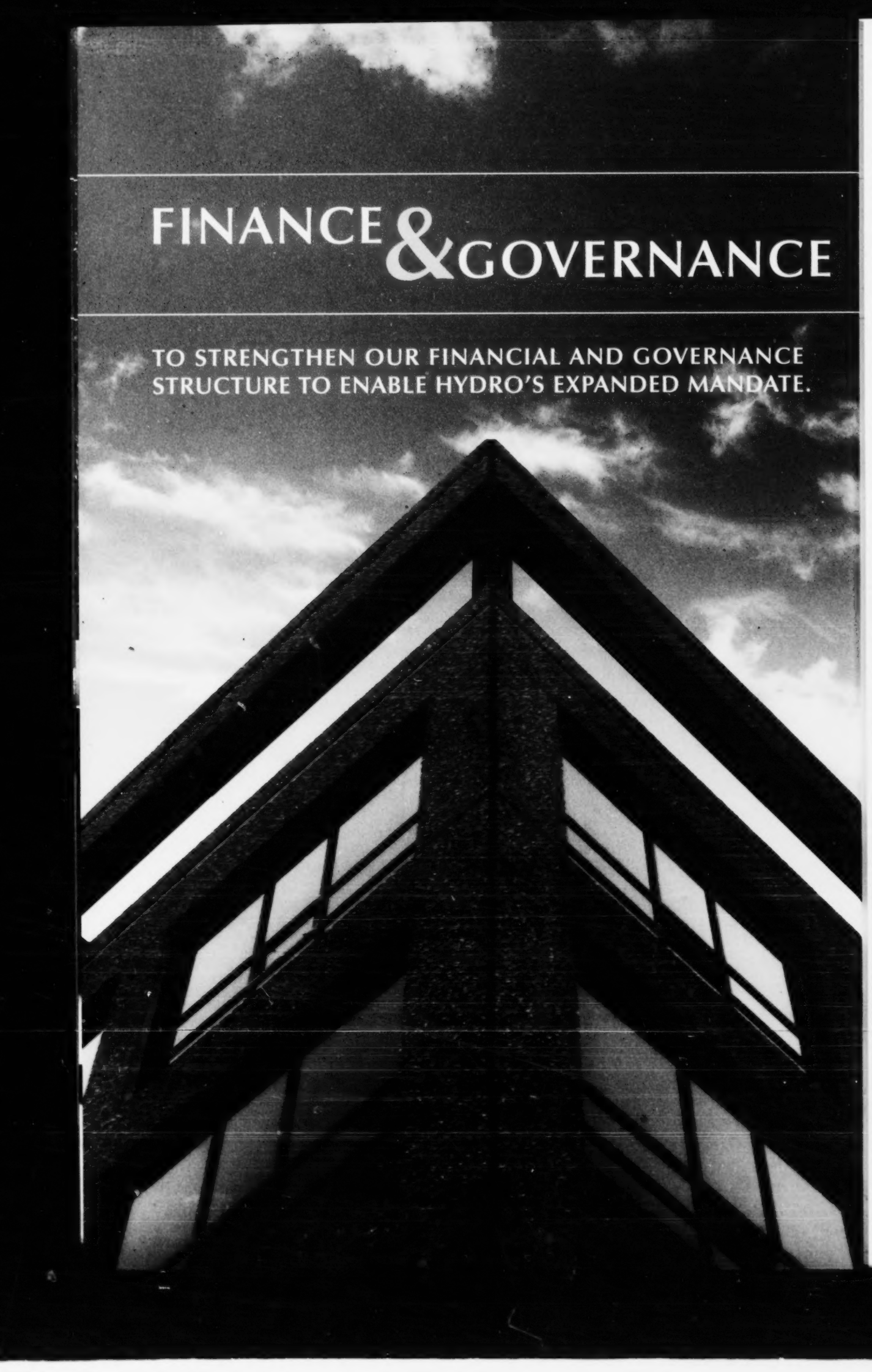
A key measure of Hydro's impact on the environment is our sulphur dioxide (SO_2) emissions from thermal generation. In 2006, we outperformed our aggressive target for reducing sulphur emissions at the Holyrood Thermal Generating Station, achieving almost a 60% reduction in emissions compared to 2005. This achievement was possible for a number of reasons: increased hydro generation due to increased water in our reservoirs; lower energy demand; and we switched to a lower sulphur fuel. The move to a 1% sulphur fuel from 2% at the Holyrood plant will reduce our SO_2 emission rate by 50% and particulate emission rate by up to 60%. We have committed to both our environmental regulator and the community that we will continue to monitor and reduce our emissions. The company is also working on a longer-term emissions strategy for the Holyrood plant.

Our objective to develop wind energy on the island also exceeded our target for 2006. Two contracts for wind projects – 27 MW in St. Lawrence and another 24 MW in Fermeuse were awarded and a power purchase agreement was signed for the St. Lawrence project. Together, these projects, when on stream in 2009, will displace 300,000 barrels of oil annually at the Holyrood plant, reduce SO_2 by over 900 tonnes, carbon dioxide by over 140,000 tonnes, and generate green energy for thousands of homes.

Our long term environmental performance and our related objective to reduce our reliance on thermal generation are also tied to energy conservation and demand management. In 2006, the company strengthened its energy conservation commitment by hiring a new Energy Conservation Program Manager to work with our partners to promote a coordinated province-wide approach to conservation education, awareness and programming. In 2007, the company, in partnership with Newfoundland Power, will complete a thorough Conservation Demand Management (CDM) Study appropriate for Newfoundland and Labrador to establish clear targets for energy conservation from CDM programs.

FINANCE & GOVERNANCE

TO STRENGTHEN OUR FINANCIAL AND GOVERNANCE STRUCTURE TO ENABLE HYDRO'S EXPANDED MANDATE.



GOOD GOVERNANCE - A FOUNDATION FOR GROWTH

The strength of our company and our new direction are supported by the work of our Board of Directors. In 2006 the Board embarked upon a comprehensive governance review which resulted in a number of recommendations and changes including the approval of revised Board Committee mandates, an auditor independence policy, a "whistle-blower" policy, and a code of business conduct and ethics. Implementation of corporate governance changes will continue in 2007.

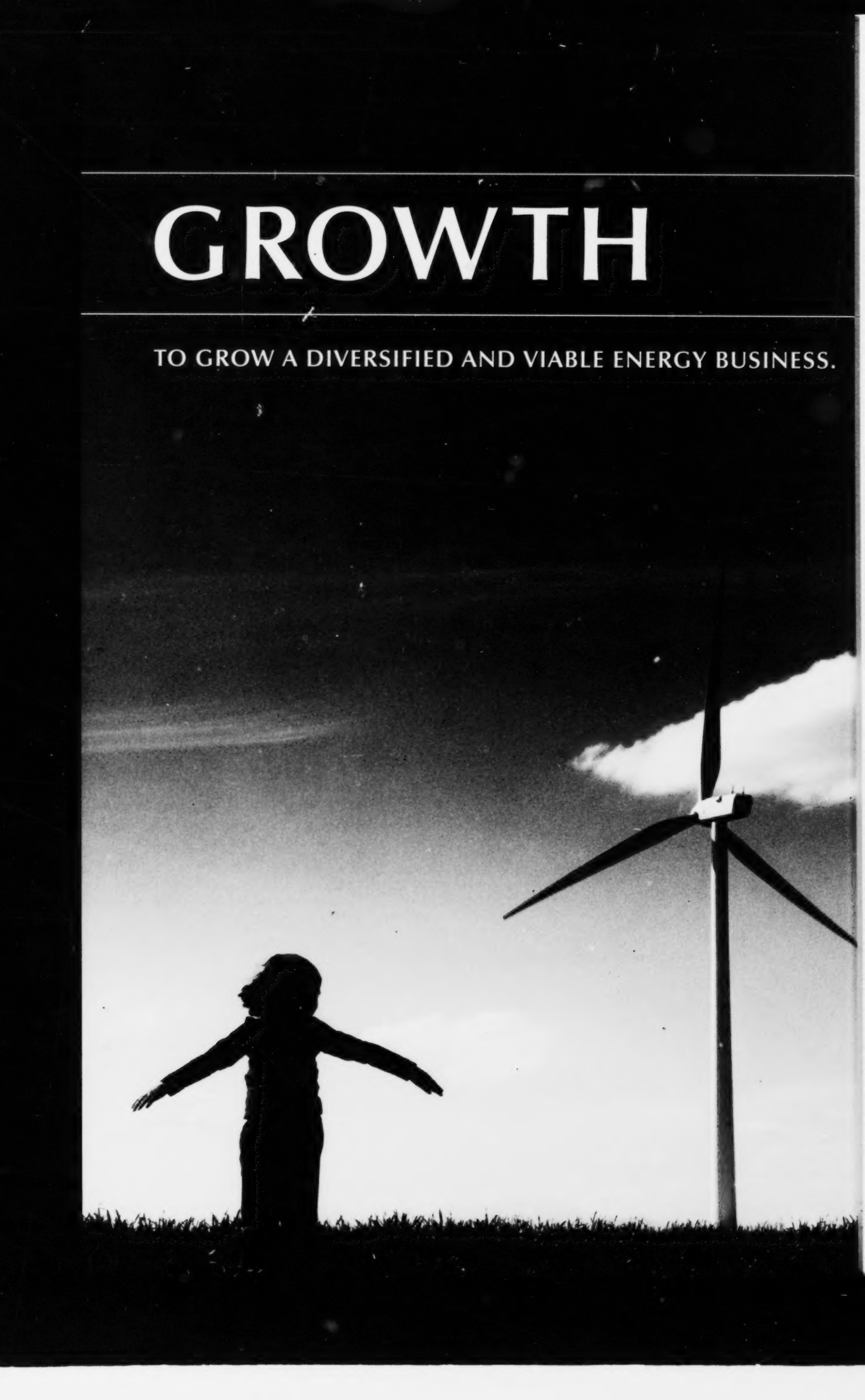
Corporate governance is the system by which businesses are directed and controlled. It specifies the distribution of rights and responsibilities between the board, managers, shareholders and other stakeholders, and spells out the policies and procedures for making decisions on corporate affairs. As we pursue our vision of a growth-oriented energy company, we are reviewing our financial and governance structures to ensure they support the vision.

In 2006, the Board of Directors established a Corporate Governance Committee to undertake a comprehensive review of the corporate governance of the company. The objective of the review was to identify and recommend implementation of best-practice governance practices.

As we start to consider investments outside of the core utility business, it is critical that we have rigorous processes for the evaluation and approval of investments. During 2006, we established a comprehensive decision gate process to ensure that the appropriate levels of analysis, diligence, review and approvals are in place to move potential investments through the various phases of development. We also established an investment evaluation group to ensure we have rigorous and consistent practices to analyze the financial returns from potential investments.

GROWTH

TO GROW A DIVERSIFIED AND VIABLE ENERGY BUSINESS.



A NEW SOURCE OF ENERGY FOR NEWFOUNDLAND AND LABRADOR

Labrador Wind

Hydro is currently monitoring Labrador's significant wind resource with the installation of four monitoring towers near Churchill Falls in an area known as Ranger Lake. Monitoring will provide valuable input to determine the potential of the resource and the feasibility of development. We are examining the wind potential from a system perspective including interconnection, power purchase agreements and technical integration issues, including integration with the Lower Churchill Project.

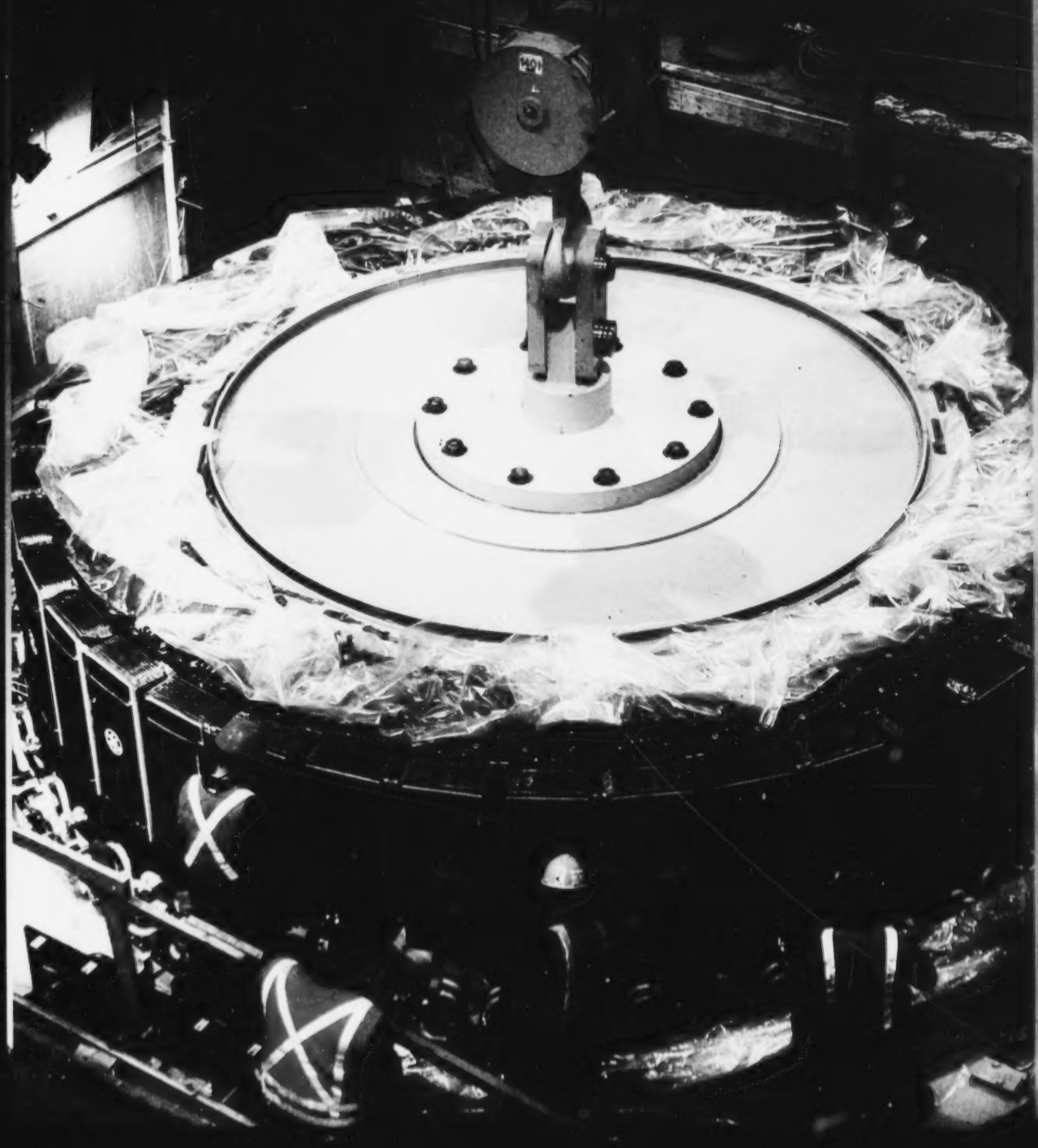
This year marked the beginning of a new era for Hydro as we worked to expand our success as an electrical utility to other areas of the energy sector. In 2006, the company developed a long term growth strategy encompassing opportunities in the broader energy sector: oil and gas; wind energy; alternative energies; and, research and development. During the year, the company began to execute the strategy primarily in the areas of wind and research and development.

We took significant steps toward the future integration of wind generation into our provincial electricity systems. Wind is a clean, renewable form of energy that offers many environmental benefits. The focus for wind power generated on the island is to supplement Hydro's existing energy supply and help reduce our reliance on thermal generation. To advance the province's commitment to renewable energy sources, Hydro awarded two contracts for over 50 MW of wind power on the island. We also started a monitoring program to provide the data required to assess the wind potential in Labrador. This monitoring program, near the Churchill Falls Generating Station, will provide information for a complete feasibility study for the potential development of the wind resource in Labrador.

Hydro secured approval and funding for an innovative research and development project to integrate hydrogen with wind power and diesel generation. This project is focused on developing an environmentally-friendly energy solution to be used in small, isolated electrical distribution systems. This project will build on the existing, successful wind-diesel system that has been operating in Ramea on the South Coast of Newfoundland since 2004.

OPERATIONAL EXCELLENCE

THROUGH OPERATIONAL EXCELLENCE TO PROVIDE EXCEPTIONAL VALUE TO ALL CONSUMERS OF OUR ENERGY.



IMPROVING RELIABILITY AND SERVICE FOR CUSTOMERS

Energy Control Centre (ECC)

At the heart of the electrical system in Newfoundland and Labrador is the Energy Control Centre powered by a new modern Energy Management System (EMS). Twenty-four hours a day, the EMS allows System Operators to see at a glance how much power is being generated throughout the system and how much is being used by customers, voltage conditions across the system and the status of virtually all equipment on the main power grid. This allows for the optimization of system performance and reliability. The operators are highly trained employees who keep their fingers on the pulse of the province's electrical pulse, monitoring consumption and striking a constant balance between supply and demand and ensuring appropriate voltage conditions.

Hydro's commitment to provide safe, reliable, least-cost energy in an environmentally responsible manner is the cornerstone of our operations. Our goal is to provide all consumers of electricity in the province with exceptional value in the areas of reliability of power supply, service and electricity rates, while maintaining a proactive approach to safety.

A key corporate measure of performance and reliability for Hydro's generating assets is availability. The availability of generating assets during the winter season is critical to ensure a stable and reliable power supply during periods of peak customer demand. For the Churchill Falls Generating Station in Labrador, success is measured by the levels at which the plant is available from November to March, the period when customer peak load demands are the highest. Plant availability is the driver for additional revenue from a Guaranteed Winter Availability Contract with Hydro-Quebec. In 2006, Churchill Falls Operations (CF(L)Co) achieved a five-month average of 99.5% of maximum additional revenue. The island generating facilities averaged 90.8% availability for January and 97.7% in February, 88.8% in March, and 95.4% in December with the drop in February and March due to an extended repair on one of the three boilers at the Holyrood Thermal Generating Station.

Continued strategic capital investment in the electricity system, combined with our ongoing replacement of aging insulators on our transmission lines and our wood pole management program directly benefited consumers. The frequency of forced or unplanned power outages was down nearly 40% from the five-year average. Our planned efforts to improve overall system performance included a focus on reducing under-frequency load shedding and faster restoration of outages. In addition to good weather conditions, this resulted in a decrease in the duration of power outages by 60% for our largest domestic customer – Newfoundland Power.

The company completed several key investments in 2006 targeting continued system reliability including the implementation of a new Energy Management System for the Energy Control Centre. Two feasibility studies were also completed for two potential hydro-electric developments at Island Pond (36 MW) and Portland Creek (23 MW).

LOWER CHURCHILL

TO ACHIEVE SANCTION FOR THE
LOWER CHURCHILL PROJECT

KEY MILESTONES ACHIEVED FOR THE LOWER CHURCHILL PROJECT

With an abundance of hydroelectric, wind and petroleum resources, Newfoundland and Labrador is an energy warehouse. A cornerstone of our energy warehouse is the lower Churchill hydroelectric resource. The 2,824 MW Lower Churchill Project will deliver a long-term supply of reliable, clean electricity to meet the growing energy demands of residential and industrial customers in the province, and potentially Ontario, Quebec, the Maritime Provinces and the northeast United States. The project will generate enough electricity to power approximately 1.5 million homes and displace 16 megatonnes of carbon dioxide emissions annually from comparable coal thermal production.

Hydro, on behalf of its Shareholder, is leading the development of the Lower Churchill Project and has established a comprehensive project execution plan. The project is advancing on multiple fronts and we are targeting sanction in 2009 and first power in 2015. The project is advancing along the critical path in six key areas: engineering, financing, environmental, commercial/market access, Innu Nation Impacts and Benefits Agreement and project execution planning.

During 2006, a number of important milestones were achieved.

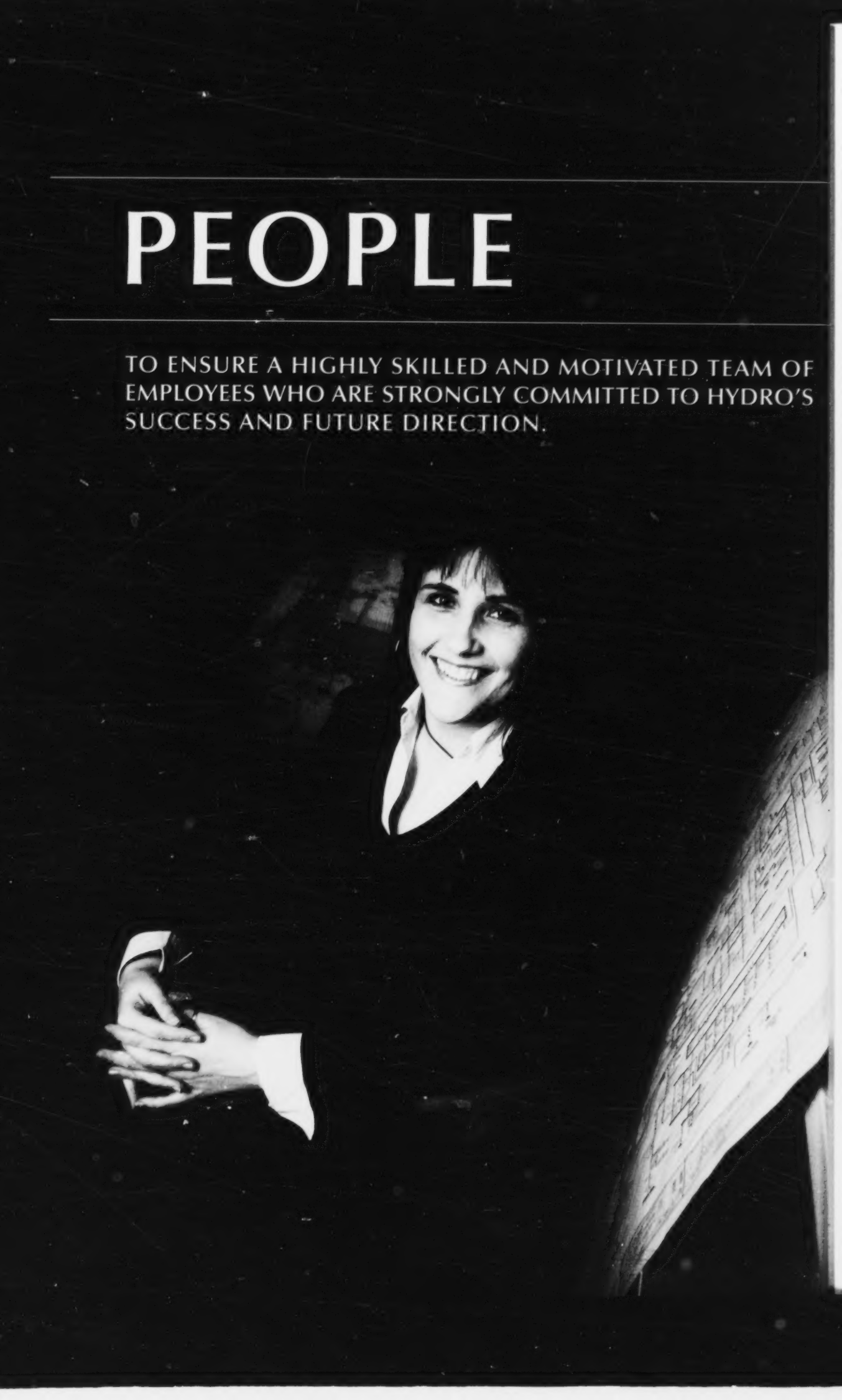
- In January, Hydro submitted an application to Hydro-Québec TransÉnergie for transmission service from the Labrador/Québec border to markets in Québec, Ontario, the Maritime Provinces and the northeast United States.
- In July, Hydro filed a request with the Ontario Independent Electricity System Operator for a connection assessment and approval for transmission into Ontario.
- In December, Hydro registered the Lower Churchill Project with the required federal and provincial environmental regulatory agencies.
- Hydro completed the majority of environmental field work for the preparation of the Environment Impact Statement.
- Hydro issued a Request for Proposals for engineering support services and financial services in December and awarded the contracts in early 2007.
- The company initiated further engineering and planning work on the potential maritime sub-sea transmission route which culminated in an application for long-term transmission service from the New Brunswick System Operator.

Environmental Assessment

Hydro has achieved an important stage in planning for the development of the hydroelectric potential of the lower Churchill River with the filing of the Registration and Project Description of the Lower Churchill Hydroelectric Generation Project for environmental assessment. This starts the formal environmental assessment processes of both the federal and provincial governments. It is a Registration under the Newfoundland and Labrador Environmental Protection Act and a Project Description intended to commence the federal environmental assessment process under the Canadian Environmental Assessment Act. Hydro is committed to a comprehensive and fully consultative environmental assessment process with stakeholders.

PEOPLE

TO ENSURE A HIGHLY SKILLED AND MOTIVATED TEAM OF EMPLOYEES WHO ARE STRONGLY COMMITTED TO HYDRO'S SUCCESS AND FUTURE DIRECTION.



EMPLOYEE OPINIONS PROVIDE IMPORTANT FEEDBACK

All of our employees play a critical role in the success of Hydro. The company is focused on a workplace where people feel valued and their skills and commitment move the company forward. This requires strong leadership at all levels, employees who are skilled, motivated and performance focused, and a collaborative relationship between union executive and Hydro management.

Employee opinion surveys are an important source of feedback to any employer seeking to communicate and learn from their employees. The development, communication and execution of a follow-up action plan flowing from Hydro's 2005 Employee Opinion Survey (EOS) was a focus in 2006, and the EOS results were a key input into a strategy supporting the achievement of the goal.

With pending retirements and an increasingly competitive labour market, a forward-looking succession plan is critical to the organization, to ensure organizational continuity. A new approach to succession planning was introduced to ensure Hydro has qualified people ready to perform in leadership and other key and critical roles.

Measuring and managing the performance of our employees is also important to help us achieve our long term goals and vision for the company. A new performance management process, aligned with the corporate planning process, for non-union employees provides a process and forum for ongoing dialogue between managers/supervisors and their employees.

The company introduced a new training and people development program focused on the continued personal and career development of our employees. It is integrated closely with our succession planning and performance management processes. This also included a renewed focus on leadership development which started with a Leadership Fundamentals program for front-line supervisors.

Another key objective was to strengthen our relationship with the International Brotherhood of Electrical Workers (IBEW). We continue to pursue opportunities for collaboration on key initiatives. We sought IBEW involvement and participation in the Corporate Safety Advisory Committee, the corporate planning process, and other working groups and committees through 2006.

In addition, Churchill Falls union and management worked together to develop and deliver a Respect and Dignity training program to all employees. Respect and dignity in the workplace is important to many of our goals and objectives including having a great workplace for our employees.

Performance Management

Our objective is to motivate individual performance consistent with corporate goals and objectives that ensures the highest sustainable value for our various stakeholders. Important components of our performance management system are the focus on feedback and the inclusion of core expected behaviours. Hydro is in the process of implementing both 180 and 360 degree feedback into its review system. As well, our core behaviours of safety, integrity, positive attitude, strong work ethic, interpersonal skills, team player, and high motivation are a critical element of individual performance.

COMMUNITY

TO BE A VALUED CORPORATE CITIZEN
IN NEWFOUNDLAND AND LABRADOR.

GIVING BACK TO NEWFOUNDLAND AND LABRADOR

Contributing to the well-being of communities in Newfoundland and Labrador is a priority for Hydro. This means being a strong member of the communities where we operate and strengthening our commitment to public safety, the environment and community investment.

To help us better understand our reputation within the community and get feedback on our performance, in 2006 we conducted a survey asking residents across the province to rate us on a number of attributes including our performance in the areas of safety, environment and conservation, community involvement and corporate leadership. The information we received summarized where we are performing well and where we need to focus our efforts to improve.

Every year, Hydro supports charities and community groups across Newfoundland and Labrador. In 2006, Hydro invested in over 200 organizations through our Community Investment Program. Some of the initiatives and organizations we supported included: the first annual Hydro Relay for Hunger, which raised more than $13,000 for the Community Food Sharing Association; the Newfoundland and Labrador Conservation Corp, including two Green Teams in Labrador; the Climate Change Education Centre; the Battle Harbour Historic site in coastal Labrador; the VON SMART in-Home Fitness Program for frail seniors; and, Hydro supplied life jackets and water safety training for Avalon Dragon Boating for breast cancer survivors.

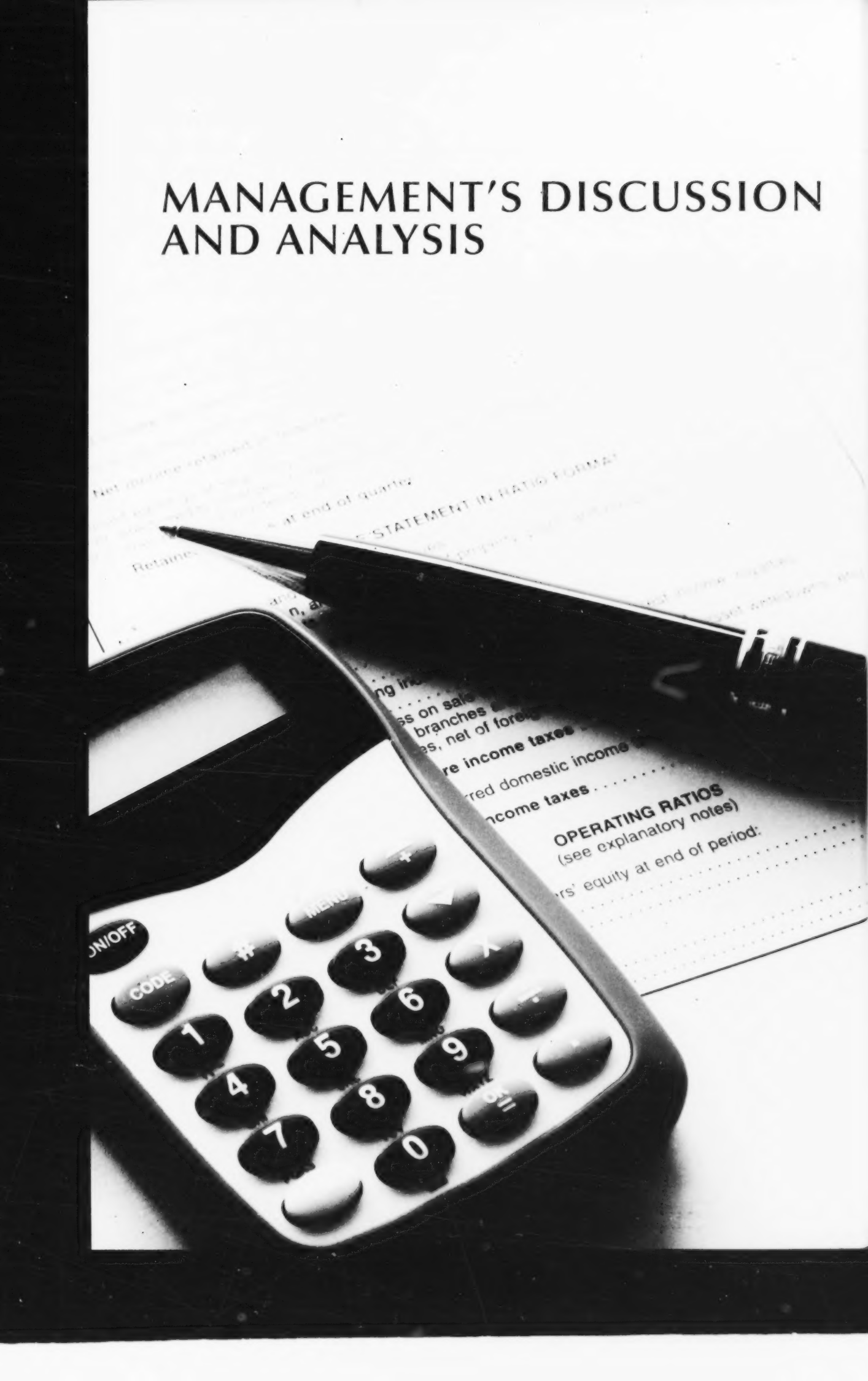
In 2006, we developed a new community investment strategy to further align our Community Investment Program with our corporate strategy, resulting in a clear focus on two key areas: Safety and Health; and Environment and Conservation.

Going forward, we will continue to identify new community partnership opportunities that align with our corporate goals and priorities. In recognition and support of the contribution our employees make in their communities, we will also work with our employees to assist and encourage them in their volunteer efforts and activities.

Labrador Green Teams

Newfoundland and Labrador Hydro sponsored two Green Teams during the summer of 2006. The Cartwright Green Team participated in an experimental peat moss transfer along the Trans-Labrador Highway. The team received in-depth training from a botanist, and continued support from a biology intern on the transfer of peat moss from donor sites to designated experimental sites. The Forteau Green Team spent most of their summer knee deep in a number of local brooks and rivers. Before work began, the team received training in testing methods from a Department of Fisheries and Oceans employee. They were responsible for completing water quality testing, which involved water temperature, flow speed, silt levels, and a flora and fauna inventory. In addition to testing, the team involved the whole town in a community wide river clean up.

MANAGEMENT'S DISCUSSION AND ANALYSIS



The following discussion and analysis is the responsibility of management and is as of April 12, 2007. The Board of Directors carries out its responsibility for review of this disclosure principally through its Audit Committee, comprised exclusively of independent directors. The Audit Committee has reviewed and approved this MD&A. The MD&A should be read in conjunction with the Consolidated Financial Statements for the years ended December 31, 2006 and 2005.

SECTION 1: CORE BUSINESSES & MARKETS

Newfoundland and Labrador Hydro (Hydro) is a Crown corporation, owned by the Province of Newfoundland and Labrador (Province), and is the parent company of Churchill Falls (Labrador) Corporation Limited (CF(L)Co), Lower Churchill Development Corporation Limited (LCDC), Gull Island Power Company Limited (GIPCo) and Twin Falls Power Corporation Limited (TWINCo).

Hydro generates, transmits and distributes electrical power and energy to utility, commercial, residential and industrial customers throughout the Province. It also sells power to Hydro-Québec, both directly, and through its subsidiary CF(L)Co. The combined installed generating capacity of Hydro and its subsidiaries, 7,288 megawatts (MW), makes it the fourth largest of all utility companies in Canada.

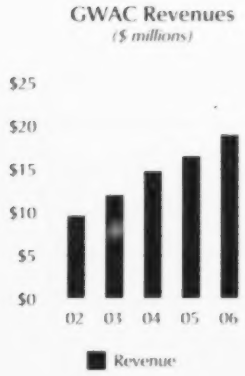
Hydro's revenues are generated from three distinct business segments: Regulated Operations; Non-Regulated Operations (other than Churchill Falls Operations) and Churchill Falls Operations.

REGULATED OPERATIONS

Hydro's regulated operations consist of sales of electricity to five industrial customers in the Province and over 35,000 residential and commercial customers in rural Newfoundland and Labrador. Hydro also supplies over 90% of the energy required by Newfoundland Power, an investor-owned utility that distributes electrical power to the balance of the population on the island portion of the Province. Hydro's regulated generating assets, with a total capacity of 1,635 MW, consist of nine hydroelectric plants, one oil-fired plant, four gas turbines and 24 diesel plants. In addition, Hydro has entered into a number of power purchase agreements with non-utility generators to supplement its own generation capacity.

NON-REGULATED (OTHER THAN CHURCHILL FALLS OPERATIONS)

Hydro's non-regulated operations consist primarily of export sales to Hydro-Québec, from a recall power sales agreement, and sales to two industrial customers in Labrador. In addition, included in this segment are activities related to the development of the hydroelectric potential of the 2,824 MW Lower Churchill



Project, as well as other non-regulated business opportunities in the energy sector, including: oil and gas; wind generation; alternative energies and research and development. When individual components in this business segment become sanctioned projects, the company will consider the appropriateness of classifying them as individual business segments.

CHURCHILL FALLS OPERATIONS

The Churchill Falls Generating Station, owned by CF(L)Co, is one of the largest underground powerhouses in the world with a rated capacity of 5,428 MW. A power contract with Hydro-Québec dated May 12, 1969 provides for the sale of almost 90% of the energy from this facility until 2041 at rates specified in the contract. Hydro owns 65.8% of CF(L)Co and recalls 300 MW, the maximum allowed under the power contract, to provide service to customers in Labrador, and sells the excess to Hydro-Québec through a recall power sales agreement.

CF(L)Co also generates revenues from Hydro-Québec under a Guaranteed Winter Availability Contract (GWAC). GWAC was signed with Hydro-Québec in 1998 and provides for the sale of additional capacity to Hydro-Québec during the months of November through March annually until the end of the power contract generating additional revenue.

SECTION 2: STRATEGY

As a traditional regulated utility, providing residents of the Province with access to safe, reliable, least-cost electricity has been the mandate of Hydro since its creation. Changes to the company's mandate in 2006 provided the platform for the company to broaden its role in the energy sector.

Hydro's core business strategy is firmly anchored in power generation, transmission and distribution activities. Its ongoing commitment to safety, environmental stewardship and operational excellence provides a foundation to its operations.

Hydro's growth strategy is to pursue energy related opportunities. The company is leading the development of the lower Churchill hydroelectric resource and is expanding its involvement in other areas of the energy sector including wind, oil and gas, alternative energies, and research and development. Hydro reorganized in 2005 to reflect its new focus and there are four lines of business within the company: Regulated Operations; Churchill Falls Operations; the Lower Churchill Project; and Business Development. The Lower Churchill Project and Business Development are both non-regulated divisions of the company.

REGULATED OPERATIONS

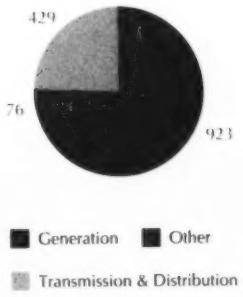
As the Province's primary generator of electricity, Hydro plays a key role in ensuring there is a safe, reliable and least-cost supply of electricity available to address current and future customer requirements.

With regulated property plant and equipment having a net book value of $1.4 billion, a key component of Hydro's regulated operations strategy is its commitment to managing these assets in a manner that minimizes the total cost of ownership, operation and maintenance, while delivering the safety, reliability and service required by its customers. As electricity generation, transmission and distribution assets age, the company's completion of a comprehensive preventative maintenance strategy and continued investment in asset upgrading and replacement will be a focus to ensure continued fulfillment of the company's mandate.

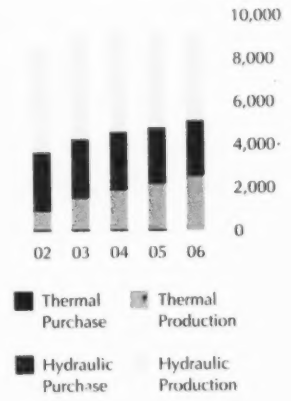
Hydro's goal of operational excellence is a cornerstone of providing exceptional value to its customers. For Hydro, operational excellence is focused on five key areas: safety, reliability, service excellence, productivity and cost management.

In addition to meeting demands of customers, Hydro will ensure there is an adequate supply of energy to meet the future needs of the residents, businesses and industry in the Province. The company is also committed to reducing its reliance on thermal generation and increasing promotion of energy efficiency and conservation.

Regulated Assets by Major Asset Group
($ millions)



Gross Energy Produced & Purchased for Provincial Use
Gigawatt Hours (GWh)



NON-REGULATED (OTHER THAN CHURCHILL FALLS OPERATIONS)

On behalf of its Shareholder, the Government of Newfoundland and Labrador, Hydro is leading the development of the Lower Churchill Project. The project strategy is focused on the activities leading to the project sanction decision expected in 2009. Hydro is also completing all the preparations necessary to deliver first power in 2015 following a sanction decision. The company is focused on identifying the appropriate combination of markets that will provide maximum value to its Shareholder, giving consideration to domestic requirements, industrial opportunities, and export markets in both Canada and the United States.

To prepare for project sanction, Hydro is focused on six key areas:

- completing the project environmental assessment;
- negotiating an Impacts and Benefits Agreement with the Innu Nation in Labrador;
- progressing engineering;
- project implementation work and schedules;
- completing a thorough market analysis and determining market access options; and
- finalizing the project financing strategy.

Hydro's new business activities are aimed at growing a diversified and viable energy business. The company's goal is to develop a portfolio of investments in the energy sector to generate value for its Shareholder by leveraging the potential of the Province's energy resources.

Establishing a wind energy business and positioning the company for leadership in this renewable energy sector is one part of the company's growth strategy. Wind energy has the potential to address electricity demands in the Province while reducing the reliance on thermal generation. It also has the potential to be developed for export to other markets. The company recently facilitated wind energy developments on the island through the award of two contracts to non-utility generators for 51 MW of wind power. This approach allows Hydro to manage its risk and facilitate faster project development, while still affording customers the benefits of a long-term, stable energy supply. Hydro also retains all emissions credits and reserves the right to purchase the developments at various intervals throughout the power purchase agreement time frames.

Participating in the oil and gas industry will also complement Hydro's current involvement in the energy sector. This participation may include obtaining equity in oil and gas developments at various stages of the value chain. Hydro is focused currently on evaluating potential investments and pursuing agreements to support the growth strategy.

Research and development opportunities related to electricity generation, transmission, and alternative energies is another focus area for the company. Hydro will work with stakeholders to establish a long-term energy innovation roadmap, and manage the delivery of energy related R&D projects, such as the recently announced Ramea Wind-Hydrogen-Diesel Generation Project.

CHURCHILL FALLS OPERATIONS

The Churchill Falls Generating Station produced over 34 terawatt hours of electricity in 2006, and almost 90% of that energy was sold to Hydro-Québec under a long-term contract. The remainder was used to serve residential, business and industrial customers in Labrador, with the surplus beyond these requirements sold to Hydro-Québec under a short-term recall power contract.

The continued pursuit of operational excellence drives every element of plant management, operations and maintenance. Focusing on safety leadership, environmental stewardship and reliability has enabled Churchill Falls Operations to consistently meet their power contract availability requirements. Critical to sustaining system performance in the future will be completing a long-term maintenance strategy and focusing on optimizing the remaining asset life, while prudently planning for asset replacement or overhaul.

SECTION 3: PERFORMANCE AND PROSPECTS

FINANCIAL OVERVIEW

millions of dollars	**2006**	2005
Revenue	**$ 548.0**	$ 532.5
Expenses	**478.0**	460.6
Net Income	**$ 70.0**	$ 71.9

Key financial performance indicators:	**2006**	2005
Return on Equity (ROE)	**12.9%**	14.4%
Debt to Capital	**70%**	74%
Interest Coverage Ratio	**1.66 times**	1.68 times
Return on Capital Employed (ROCE)	**8.7%**	8.8%

Description of Performance Indicators

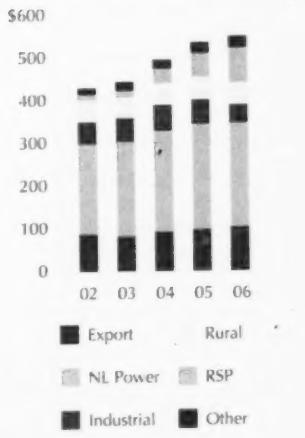
Return on Equity *– Net Income/Average Equity.*
Debt to Capital *– Year-end total debt balance expressed as a percentage of the total capital structure.*
Interest Coverage Ratio *– The extent to which income before financing charges is able to cover interest obligations.*
Return on Capital Employed *– Net Income plus Interest/Average Debt plus Equity*

This section provides an overview of Hydro's financial performance based on its Consolidated Financial Statements. Certain figures from the prior year have been reclassified to conform with the current year's presentation.

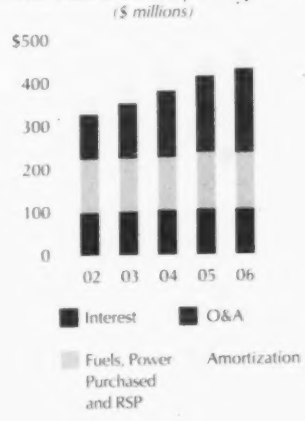
The ROE in 2006 decreased from 2005 due primarily to an increase in equity as a result of a suspension in dividend payments during 2006. Similarly, the improvement in the debt portion of the capital structure from 74% in 2005 to 70% in 2006 is primarily due to continued strong earnings and the significant reduction in dividend payments during 2006. This is a very positive step for Hydro's financial position to enable future growth and financing from external sources.

ROCE was stable in the 2005-2006 timeframe, following an increase in 2005, due largely to the full-year impact of a rate increase implemented in late 2004.

Five-Year Summary of Revenue
($ millions)



Five-Year Summary of Expense
($ millions)



BUSINESS SEGMENT REVIEW

Hydro reports its operational results in three business segments: Regulated Operations, Non-Regulated Operations (not including Churchill Falls) and Churchill Falls Operations. These business segments are differentiated on the basis of regulatory status and management accountability.

millions of dollars	**2006**	2005
Segment Income (loss)		
Regulated Operations	**$ (6.9)**	$ 3.3
Non-Regulated Operations	**$ 50.5**	$ 47.2
Churchill Falls Operations	**$ 26.4**	$ 21.4
	$ 70.0	$ 71.9

Regulated Operations

Factors that Shaped 2006 Regulated Operations Business Conditions: Hydro's operations are impacted by several external factors; primarily, the domestic economy, weather patterns and fuel costs. A favourable economic climate over the medium and longer term is critical to sustaining the electricity generation, transmission and distribution business since it creates the economic activity and income flows that drive the demand for electricity.

Real Gross Domestic Product (GDP) for the Province is estimated to have grown by 3% in 2006, somewhat below what had been anticipated due to lower than expected oil production. Mineral exports and consumer spending were strong contributors to provincial economic growth in 2006. Employment grew slightly for the year, real wages were higher and core inflation remained moderate.

In 2006, the provincial demand for electricity declined by over 4%, due primarily to the closure of the newsprint mill in Stephenville late in 2005. A fourth consecutive year of warmer than normal weather conditions also contributed to a reduced electricity demand related to electricity space heating. Also, continued challenges within the seafood industry resulted in lower electricity sales to this commercial sector.

A positive aspect in 2006 was the near record output levels for the island's hydroelectric plants. When combined with lower customer energy requirements, Hydro was able to minimize the high-cost production from the Holyrood Thermal Generating Station to 740 GWh net; the lowest thermal output since 1983. The market price for heavy fuel oil in 2006, at $52 per barrel, was only marginally higher than 2005 market prices.

The primary reasons for a reduction in regulated net income of $10.2 million from 2005 to 2006 are:

- an increase in amortization of $1.1 million;
- an increase in power purchases of $2.9 million;
- an increase in interest expense of $2.9 million; and
- an increase in fuel costs of $1.7 million due to lower operating efficiency at the HTGS, which was due to lower energy requirements on the island.

Hydro filed a General Rate Application (GRA) with the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) on August 3, 2006, seeking increases to its customer rates to achieve a level of profitability in 2007. Hydro's rate request included forecast increases in all expense categories including: higher operating and maintenance, fuel, power purchases, depreciation and interest costs.

Subsequent to the GRA filing there were negotiations with the intervening parties to the hearing seeking to settle as many of the issues as possible. Several agreements were reached during this process resulting in settlement of all significant issues including customer rates resulting in a more expeditious rate process and a decreased cost to electricity consumers. This was the first negotiated settlement in this jurisdiction. As a result of several factors, including reduced interest and fuel price forecasts and the use of a balance in a rate stabilization hydraulic reserve, there was little or no increase in electricity rates for many customers throughout Newfoundland and Labrador for 2007. As well, primarily due to a $10.0 million payment into the Rate Stabilization Plan (RSP) in 2006 by the Government of Newfoundland and Labrador, to offset the accumulated debt in the RSP, Island Industrial Customers experienced a decrease of 18.3%. The PUB granted interim approval of rates effective January 1, 2007. Final approval was granted by the PUB in April 2007.

Hydro's rates are based on an approved return on regulated equity of 4.47% for the purpose of determining its cost of capital. This level of return is based on a previous PUB decision which established the ROE at a rate equal to the long-term marginal cost of debt. There continues to be inherent risks of a low rate of return on Hydro's invested capital, and it is the company's intention to bring this issue to the PUB for reconsideration in the future.

Revenue :

millions of dollars	**2006**	2005
Newfoundland Power	**$ 241.8**	$ 244.8
Industrial Customers	**37.5**	52.5
Rural Customers	**51.1**	52.6
Rate Stabilization Plan (RSP) Recovery	**83.6**	56.5
Other	**2.5**	2.3
	$ 416.5	$ 408.7

Regulated Operations *(continued)*

Sales revenues in 2006, exclusive of the RSP Recovery, of $83.6 million, decreased due to a reduction of $15.0 million in industrial sales; a $3.0 million reduction in sales to Newfoundland Power; and a $1.5 million reduction in rural revenue. The reduction in industrial sales is primarily attributable to the closure of the newsprint mill in Stephenville, with a 70 MW load, in late 2005. Warmer weather conditions and continued challenges in the seafood industry contributed to lower sales to Newfoundland Power and rural customers. Reductions in revenue from lower sales to industrial customers, Newfoundland Power and interconnected rural customers were offset by lower fuel expense at the Holyrood Thermal Generating Station, and in combination with the operation of the RSP, had no significant impact on net income.

Fuel: Regulated operations utilized No. 6 fuel oil at the 490 MW thermal generating station at Holyrood and diesel fuel at its 24 diesel plants.

millions of dollars	**2006**	2005
No. 6 Fuel		
Consumption (millions of bbl)	**1.3**	2.1
Purchase price ($/bbl)	**50.50**	37.59
Total costs	**$ 63.5**	$80.3
RSP deferral	**(3.9)**	(6.3)
No. 6 Fuel Expense Total	**$ 59.6**	$ 74.0
Diesel Fuel Expense	**10.4**	9.7
Other	**1.0**	0.8
	$ 71.0	$ 84.5

Overall, fuel expense decreased from $80.3 million in 2005 to $63.5 million in 2006. There were three factors influencing the No. 6 fuel expense: price, production and plant efficiency.

- Although the price of No. 6 fuel increased by 34% in 2006 over 2005, the volume consumed declined by 38%, or 800,000 barrels.
- Production from the plant in 2006 was 740 GWh compared to 1,328 GWh in 2005, a 44% reduction. The lower production levels were primarily due to higher water levels in the hydro reservoirs, favourable weather conditions and a reduction in load due to the closure of a major industrial customer in late 2005.

- As a result of lower production, there were efficiency declines. The conversion factor (number of kWh from a barrel of fuel) which resulted from the lower production levels caused fuel expense to increase by $1.7 million over what would have been achieved if the 2005 level of efficiency had been met.

Diesel fuel expense increased by $0.7 million from $ 9.6 million in 2005, to $10.3 million in 2006. This increase is attributable to a 12% increase in the average price from $0.66 per litre in 2005 to $0.74 per litre in 2006. This was partially offset by a reduction in consumption of 5% from 14.6 million litres to 13.9 million litres as a result of favourable weather conditions and the interconnection of the community of Rencontre East to the island electrical grid.

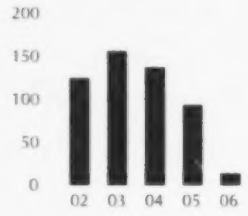
Rate Stabilization Plan (RSP): The RSP was established in 1936 to mitigate the impact of volatile fuel prices on electricity rates. The difference between the cost of fuel consumed to generate electricity and the cost upon which electricity rates are based accumulates in the RSP. Balances which accumulated prior to December 31, 2003 are being recovered from customers over a four-year period which commenced in 2004. As of December 31, 2006, $63.1 million remains to be recovered.

Balances accumulating in the RSP subsequent to 2003 are recovered in the following year, with the exception of the hydraulic variation, which is recovered or refunded at a rate of 25% annually. The hydraulic variation results from having higher than average water available for hydroelectric production, reducing the need for thermal generation and the related fuel costs. Rates are adjusted annually based on forecast fuel prices. This is known as a fuel rider.

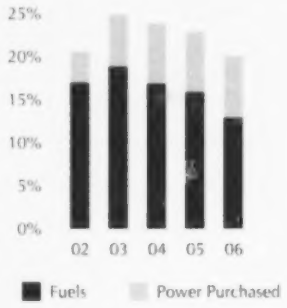
Power Purchased: To supplement Hydro's electricity generation, the company purchases power under long-term agreements with non-utility generators. Power purchase costs increased by $2.9 million to $38.8 million in 2006. This was due to increased energy purchases from all power purchase agreements. The increased power purchases of 25.9 GWh in 2006 offset approximately $2.0 million of fuel at the Holyrood Thermal Generating Station.

Interest: Hydro's investment in property plant and equipment is financed in part through debt. Interest expense increased by $2.9 million from $99.5 million in 2005 to $102.4 million in 2006. This is primarily due to a combination of changes in short and long-term debt balances and rates. The balance of long-term bonds outstanding increased from $1,400.0 million to $1,425.0 million while the average interest rate declined from 7.3% to 7.2% for a net increase in interest expense of $1.3 million. The remaining change is due to lower balances and higher interest rates on short-term debt.

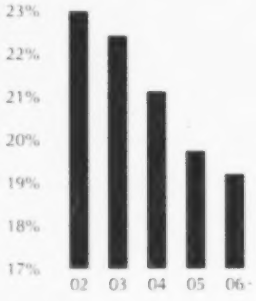
RSP Plan Balances
($ millions)



Five-Year Summary of Fuel and Purchased Power Costs as a Percentage of Revenue



Five-Year Summary of Finance Charges as a Percentage of Revenue



Hydro tracks its performance relative to a number of reliability indices and monitors customer satisfaction.

Non-Financial Performance Indicators:	**2006**	2005
Weighted Capability Factor (% of time available)	**83.50**	84.90
Holyrood Thermal Conversion Factor (kwh/bbl)	**589**	622
SAIFI - Transmission (interruptions/delivery point)	**1.63**	1.52
SAIFI - Distribution (interruptions/customers)	**5.38**	5.83
SAIDI - Transmission (minutes/delivery point)	**151.32**	98.5
SAIDI - Distribution (hours/customer)	**8.02**	8.80
Residential Customer Satisfaction Index	**8.0**	8.2
Commercial Customer Satisfaction Index	**8.4**	8.3

Description of Performance Indicators

Weighted Capability Factor *– Percentage of time that generating units are available to supply load.*
Holyrood Thermal Conversion Factor *– Net kWh generated/barrels of No. 6 fuel consumed.*
System Average Interruption Frequency Index (SAIFI) *– Total number of sustained outages/total number of delivery points or customers. An outage is sustained if over 1 minute in duration. For transmission, denominator is delivery points, for distribution it is customers. This is used to track the overall performance of Hydro's transmission and distribution system.*
System Average Interruption Duration Index (SAIDI) *– Total duration (minutes) of all outages/number of delivery points or customers. For transmission, denominator is delivery points, for distribution, it is customers. This is used to track the performance in responding to outages.*
Customer Satisfaction Index *– The weighted average of satisfaction ratings of the service attributes, based on annual customer surveys, on a scale of 10.*

Performance was relatively consistent with respect to most of the non-financial performace indicators. The decline in the Holyrood Thermal Conversion Factor is due primarily to the lower production levels at the Holyrood plant in 2006. The SAIDI for transmission declined during 2006 due to an increase in the duration of planned maintenance outages at various locations. Forced outage durations remained almost unchanged. Both SAIDI and SAIFI for distribution improved in 2006.

Non-Regulated (other than Churchill Falls Operations)

Non-Regulated Operations consists of five specific types of business activities:

a) Sale of excess recall power by Hydro to Hydro-Québec under a power contract that expires in 2009. This activity accounts for the majority of the net income in this business segment. In 2006, revenues from this activity were $52.4 million (2005 - $49.3 million) and net income was $48.6 million. Additional energy was available in 2006 for sale to Hydro-Québec due to lower requirements to serve Labrador interconnected customers.

b) Sale of power to the iron ore mining industry in Labrador. In addition to power supplied to the iron ore industry through TWINCo, Hydro also makes direct sales to the iron ore industry. These direct sales in 2006 were $5.0 million.

c) Activities related to the development of the lower Churchill hydroelectric resource in Labrador. During 2006 all expenditures related to this activity

($14.5 million) were capitalized, thereby having no impact on net income. The increase in non-regulated assets reflects the continued investment in the Lower Churchill Project.

d) Costs related to business development activities with respect to Labrador wind, potential oil and gas investments, research and development and other business development activities. In 2006 none of these activities were in a commercial stage and as a result did not produce any revenues. Costs expensed and capitalized in 2006 were $0.8 million and $0.3 million respectively.

e) Other costs, including amounts that are not permitted by the regulator to be recovered in rates and costs incurred with respect to corporate activities. In 2006 these costs were $0.9 million. Interest income increased to $1.3 million due to the suspension of dividend payment effective March 1, 2006.

This segment also includes LCDC and GIPCo. Both are inactive companies and had minimal transactions in 2005 and 2006.

Churchill Falls Operations

Hydro holds a 65.8% investment in CF(L)Co, with Hydro-Québec holding the remainder. As a result of a Shareholders' Agreement between Hydro, Hydro-Québec and CF(L)Co, Hydro accounts for its investment as a joint venture (see Note 1 to Consolidated Financial Statements). The Consolidated Financial Statements include 65.8% of the revenues, expenses, assets and liabilities of CF(L)Co.

During 2006, net income from Churchill Falls Operations was $26.4 million, an increase of $5.0 million compared to 2005. This increase was due primarily to an increase in revenue. Revenue increased by $4.2 million, or 6% mainly due to a $5/kW increase in the GWAC rate, as well as an increase in sales to Hydro-Québec.

2007 FINANCIAL AND BUSINESS OUTLOOK

In 2007, Hydro expects an overall improvement in financial performance and condition due to a January 1, 2007 rate change that restores the profitability of Regulated Operations. In addition, the Shareholder, upon the recommendation of the Board of Directors, has agreed to suspend dividend payments throughout 2007.

The company's capital program in 2007 is approximately $100 million. It is anticipated that Hydro will fund these activities primarily through internally generated cash flow, supplemented by short-term promissory notes.

Commencing January 1, 2007, CF(L)Co will start making annual payments to accumulate a $75.0 million Reserve Fund as per the Shareholders' Agreement to contribute towards the funding of capital expenditures related to Churchill Falls'

existing facilities and its replacement. It is anticipated that CF(L)Co will have sufficient cash flow from operations to fund both the initial $17.0 million Reserve Fund payment and 2007 estimated capital expenditures of $11.5 million.

The company will also continue to analyze and assess other investment opportunities in 2007. Should these opportunities develop further, financing considerations and options will be addressed. Depending on the size of the investments, Hydro will determine whether additional borrowing is required. Hydro had $300.0 million borrowing capacity available through its line of credit and promissory note capacity at the end of 2006.

FINANCIAL CONDITION REVIEW

Total assets were $2,216.0 million at December 31, 2006, up $11.9 million or 0.5% over December 31, 2005. Total liabilities decreased $55.5 million from December 31, 2005 to $1,639.1 million at December 31, 2006 and total shareholders' equity increased $67.4 million to $574.4 million over the same period.

Assets

There were a number of contributors to the increase in assets. Long-term receivables increased by $17.8 million due primarily to a refundable deposit associated with an application for transmission service into Québec. Sinking funds increased by $11.5 million. Additions of $60.9 million to property, plant and equipment were offset by amortization of $48.5 million. Cash and short-term investments increased by $12.6 million. These were offset by a decrease in regulatory assets, primarily the continued collection of the long-term receivables, including a $10.0 million contribution from the Province in relation to balances primarily attributable to a former industrial customer.

Hydro invested $60.9 million in various capital projects during 2006 compared to $47.7 million in 2005. This is the highest level of capital investment since the completion of the Granite Canal project in 2002-2003.

millions of dollars	**2006**	2005
Capital Expenditures		
Regulated Operations	**$ 41.6**	$ 36.4
Non-Regulated Operations	**14.7**	5.3
Churchill Falls Operations	**4.6**	6.0
	$ 60.9	$ 47.7

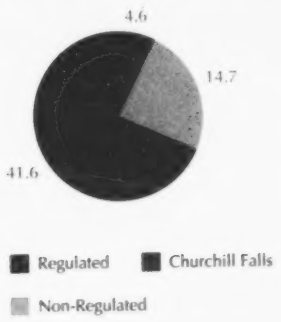
Major capital investments for Regulated Operations included:

- $9.1 million for improvements to the Distribution Systems;
- $5.5 million for replacement of the Energy Management System;
- $3.5 million for replacement of the VHF Mobile Radio System; and
- $3.4 million to upgrade the Transmission Systems.

The majority of the capital expenditures for Non-Regulated Operations of $14.7 million was related to the potential development of the lower Churchill.

The most significant capital project in Churchill Falls was the replacement of the SCADA energy control system at a cost of $1.5 million.

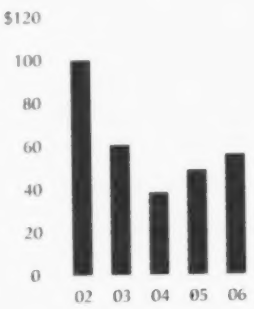
2006 Total Capital Expenditures
($millions)



Liabilities

The decrease in liabilities was attributable to a reduction in short-term borrowings of $92.0 million as a result of the suspension of dividend payments and, offset by an increase of $37.6 million in regulatory liabilities, specifically the balance in the RSP. The balance owing in the RSP arose from a combination of higher hydraulic production and lower customer load.

Five-Year Summary of Capital Expenditures
($ millions)



Equity

Retained earnings increased at December 31, 2006 compared to December 31, 2005 arising from net earnings for 2006 of $70.0 million, offset by dividends paid of $2.6 million, for a net increase in retained earnings of $67.4 million.

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

Cash flows from operating, investing and financing activities are summarized in the following table:

millions of dollars	**2006**	2005
Cash provided by (used in)		
Operating activities	**$ 176.9**	$ 168.6
Financing activities	**(84.0)**	(93.7)
Investing activities	**(86.4)**	(73.9)
Net increase in cash	**$ 6.5**	$ 1.0

Liquidity requirements can be met through a variety of sources, including cash generated from operations, short-term borrowings and issuance of long-term debt. Hydro's primary uses of funds are operating expenses, capital spending,

and interest and principal payments on its debt.

Cash provided by operating activities increased by $8.3 million or 5% in 2006. This favourable variance is mainly attributable to an overall reduction in net balance of the RSP, partially offset by an $18.1 million increase in refundable deposits associated with an application for transmission service with Hydro-Québec.

Cash used in financing activities decreased by 10% or $9.7 million, primarily as a result of the decision to suspend dividends from March 2006 until March 2008. Cash used in investing activities increased by 17% or $12.5 million. This was due to greater additions to property, plant and equipment.

The company believes that internally generated cash flow and borrowing from existing financing sources will be sufficient to meet its anticipated capital expenditures and other cash requirements in 2007.

CAPITAL STRUCTURE

millions of dollars	**2006**	2005
Short-term debt	**$ 58.8**	$ 150.8
Current portion of long-term debt	**22.5**	222.6
Long-term debt (net of sinking funds)	**1,281.1**	1,089.0
Total debt	**$ 1,362.4**	$ 1,462.4
Shareholders' Equity	**574.4**	507.0
Total Debt to Capital	**70%**	74%
Fixed Rate Debt as a percentage of total indebtedness	**96%**	90%
Dividend Payout Ratio	**4%**	78%

Hydro uses a combination of short-term and long-term debt to finance its operations, with fixed interest rates on both short-term and long-term debt for the term of the instrument.

Hydro utilizes a short-term promissory note program for its daily funding requirements. This program has an authorized limit of $300.0 million and is guaranteed by the Province. The current credit rating of R1(low) assigned to this program by Dominion Bond Rating Service (DBRS), combined with the provincial guarantee, allows Hydro to access short-term funds in the Canadian Money Market at attractive rates. Unsecured bank credit facilities are also in place in the amount of $50.0 million for Hydro and $10.0 million for CFLCo.

Long-term capital markets are the principle source of longer-term funding for Hydro. Hydro's debenture issues are currently assigned A(low) credit rating by

DBRS, and are also fully guaranteed by the Province. Hydro's total borrowings outstanding, net of sinking funds and exclusive of borrowings pertaining to CF(L)Co, are limited by legislation to $1,600.0 million. As at December 31, 2006, Hydro's total borrowings outstanding were $297.0 million below this limit.

The operations of CF(L)Co are financed by cash from operations. The original capital investment in property, plant and equipment was financed by private placement, longer-term fixed rate debt instruments, some of which were denominated in U.S. dollars. Almost all foreign exchange rate risks are borne by Hydro-Québec. Under the contract terms, the first six percent of foreign exchange risk is shared and the rest is borne by Hydro Québec. The debt is secured by the project assets.

The debt to capital improved from 74% to 70% in 2006. This improvement was primarily due to the suspension of the payment of common dividends until the end of March 2008. The Board of Directors, in conjunction with the Shareholder, determined that this reduction in dividends was desirable in order to provide cash flow to enable Hydro to execute its expanded mandate with respect to the Lower Churchill Project, wind, oil and gas and other investments.

For 2006 the weighted average cost of debt on a consolidated basis was 8.41%, compared to 8.13% in 2005.The increase in 2006 was due largely to upward pressure on short-term rates.

Derivative Instruments

Periodically the company uses derivative instruments to manage its exposure to interest rate and foreign exchange risk. Hydro may enter into transactions that do not qualify for hedge accounting under Canadian Generally Accepted Accounting Principles (GAAP) but nevertheless are utilized to adjust risk exposure to acceptable levels as approved by the Leadership Team and the Board of Directors. Transactions of this nature are recorded at their fair market value on Hydro's Consolidated Statement of Financial Position and are marked to market each reporting period.

Hydro employs forward contracts for the purchase of U.S currency in advance of a major currency requirement for a delivery of Bunker C fuel oil. There were no such contracts outstanding as at December 31, 2006.

The company has occasionally used interest rate swaps to manage the interest rate mix in the overall debt portfolio within approved exposure limits. No interest rate swaps have been used in the past two years.

OBLIGATIONS AND COMMITMENTS

millions of dollars	2007	2008	2009	2010	2011
Debt Repayments (1)	$ 14.4	$ 201.0	$ 1.0	$ 35.9	$ -
Sinking Fund Installments	8.1	8.1	8.1	8.2	8.2
Reserve Fund Payments (2)	11.2	11.2	11.2	5.3	5.3
Capital Projects	9.9	-	-	-	-
Power Purchase Agreements (3)	35.3	37.1	43.7	50.2	55.4
Total	$ 78.9	$ 257.4	$ 64.0	$ 99.6	$ 68.9

Notes:

1) Includes repayment of long-term debt. The repayments in 2008 includes the maturity of a $200.0 million ten-year bond. Hydro anticipates that this bond will be replaced with another long-term bond issue.

2) In accordance with the Shareholders' Agreement, CF(L)Co is required establish a $75.0 million Reserve Fund for major repairs, commencing with an initial payment on January 1, 2007. This item reflects Hydro's 65.8% share of the total Reserve Fund payments.

3) Hydro has entered into a number of power purchase agreements with remaining terms ranging from 12 to 26 years.

RELATED PARTY TRANSACTIONS

Hydro purchases power from CF(L)Co to serve customers in Labrador and for sale to Hydro-Québec. Purchases in 2006 were $6.1 million, the same as 2005. Additionally, in the normal course of operations, Hydro provides certain engineering, technical, management and administrative services to CF(L)Co. Fees paid by CF(L)Co to Hydro for these services amounted to $1.9 million in 2006, compared to $2.2 million in 2005.

Payments to the Government of Newfoundland and Labrador:

millions of dollars	**2006**	2005
Debt Guarantee Fee	**$ 14.0**	$ 14.4
Water Rentals and Royalties	**6.0**	5.4
Total	**$ 20.0**	$ 19.8

SECTION 4: MANAGING RISK

Risks are identified and assessed based on the estimated likelihood of occurrence and the severity of the impact of a potential loss. Exposures that could have significant impact on the corporate strategic goals are identified and mitigation activities are undertaken to provide reasonable assurance the exposures will not prevent us from achieving corporate goals and objectives. Through continual updating of its risk management practices, the company ensures the protection of the physical and financial assets. Hydro has identified two major categories of risks: operations and financial.

OPERATIONS RISK

Three areas of main business risk in this category include: major damage to critical assets; interruption of electrical service; and liability to third parties arising from property damage, bodily injury or death. To eliminate or lessen the impact such risks may have, Hydro has developed regular maintenance and inspection programs for all assets; initiated redundancy of critical assets; and completed loss analysis of all incidents to enhance loss-prevention programs.

The corporate insurance program, covering all assets and specified liabilities, is reviewed and negotiated with insurers annually. The review focuses on exposures to loss, adequacy of coverage limits, deductible levels, self-insured exposures and loss history. The company develops strategies to ensure the provision of optimal coverage terms at a competitive cost when the annual review is completed.

Hydro is currently in the process of developing and implementing business continuity plans for events that could cause a complete disruption of essential service for an extended period of time. These plans will be used to identify and categorize potential catastrophic events and document procedures to ensure minimum essential service is provided, as far as reasonbly possible, until full service can be restored.

During the past year, Hydro assessed its state of emergency preparedness as it relates to its readiness to support plants and/or facilities during major emergencies. The company will use the results of this review to enhance its comprehensive corporate emergency response plan.

Hydro also initiated an enhanced maintenance planning activity to ensure the company plans its long-term maintenance to maximize plant availability in the most efficient manner.

Safety

Hydro is committed to being a safety leader and has developed and is implementing a multi-year safety strategy aimed at enhancing the core elements of a strong safety culture.

Leadership commitment to safety from the company and the International Brotherhood of Electrical Workers (IBEW) is an important part of this safety strategy. This visible commitment is vital to elevating the importance of safety in all Hydro operations. Leadership review of safety performance on a frequent, regular basis and active involvement in incident investigation and action planning are fundamental and ongoing.

Hydro has placed an increased focus on reporting safety hazards, near misses and minor incidents. Identifying these less serious events and implementing corrective actions will prevent more serious injuries and major losses from occurring.

Information Technology

Information technology affects all aspects of Hydro's operations. Major risk exposures in this environment include: the loss of processing capability due to hardware or software failure, the loss of communication capabilities across the wide area network and the threat of computer virus attacks on the company's computer system.

In the event of a major hardware failure, the company has retained a service provider to help restore critical business systems. The service provider supplies a back-up site along with all the necessary hardware and communication links. Hydro maintains a Disaster Recovery Plan that details the actual recovery procedures and processes. The Plan is updated and tested on a regular basis. The Energy Management System, that controls all generation and transmission activities, has a new backup Energy Control Centre in a separate facility.

The threat of computer virus attacks on Hydro's computer system is mitigated through the use of firewalls, anti-virus tools and detection/intrusion prevention appliances. Internet access is tightly controlled and managed by a web filtering device that reduces the risk of picking up malicious code from questionable sites.

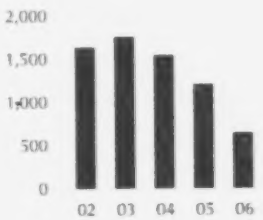
Environmental

The number and diversity of environmental risks facing the company requires a structured and consistent management approach. Hydro has chosen the ISO 14001 Environmental Management System (EMS) standard developed by the International Organization for Standardization to drive continual improvement of the mitigation of environmental risks, while fulfilling its mandate to provide customers with

safe, reliable and least-cost power. Targets for improvements to the company's EMS are established and monitored as part of its corporate goals and objectives.

Hydro mitigates environmental risk through adherence to the various principles of the EMS, which include regular internal environmental compliance audits, surveillance audits by an outside contractor and recertification as ISO 14001 compliant.

Debt Outstanding at December 31
($millions)



FINANCIAL RISK

Hydro operates in an environment with various forms of financial risk including changes in interest rates, and fluctuation in foreign currency exchange rates and commodity prices. Hydro utilizes a combination of financial instruments and portfolio management to manage these risks.

Interest Rates

Hydro manages its exposure to interest rates through ongoing benchmarking against key indices, an assessment of acceptable risk tolerance levels and the occasional utilization of derivative instruments to manage risk exposure within established parameters. Hydro has a diversified portfolio of fixed and floating rate debt which is formulated and managed with a view to an acceptable risk profile. Current guidelines limit floating rate exposure to a maximum of 17% of Hydro's total debt. In 2007, Hydro's floating rate debt is not expected to exceed 7% of total debt outstanding, with an average level of 4.5% for the entire year. At this average level of floating rate exposure, Hydro's interest expense can be expected to increase by $0.6 million for every 1% change in interest rates.

As at December 31, 2006, Hydro's short-term debt (comprised of promissory notes) was $58.8 million, the current portion of long-term debt was $22.5 million and long-term debt was $1,378.4 million. Long-term debt is comprised primarily of $1,341.0 million of debentures net of sinking fund investments in its own debentures that were issued carrying the full guarantee of the Province. Hydro also has $97.3 million in sinking fund investments in other entities. Authorized sinking fund investments of this nature are governed by the terms of each bond issue and in general, are limited to obligations issued or guaranteed by the Government of Canada or any province of Canada. At December 31, 2006 and 2005, Hydro had no interest rate swap agreements outstanding.

If interest rates changed significantly, management would likely take actions to manage the company's exposure to the change. However, Hydro has set current levels of exposure to floating rates based on sensitivity analyses performed in the context of historical movements in rates. In that manner the company

attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Foreign Exchange and Commodity Prices

Hydro mitigates its foreign exchange exposure through a diversified approach that includes the periodic use of forward currency contracts. All long-term debt is denominated in Canadian dollars, with the exception of the CF(L)Co First Mortgage Bonds (FMB) that are denominated in U.S. dollars (U.S. $10.6 million). The objective is to avoid exposure to foreign exchange rate fluctuations on the payment due date, by making strategic purchases of portions of the currency requirement up to thirty days in advance utilizing forward contracts. In accordance with the Power Contract, almost all of the foreign exchange exposure associated with the FMB Series A debt is borne by Hydro-Québec. As at December 31, 2006 there were no forward contracts outstanding.

Exposure to changes in No. 6 oil prices is primarily mitigated through the operation of the RSP. In 2006, Hydro had total purchases of $56.9 million (2005 - $89.7 million). Hedging programs could be considered in order to reduce exposure to unfavorable price movements on input costs that cannot be passed on to customers. Such a program is considered unnecessary for Hydro, since as a regulated utility, the regulator has approved an RSP which mitigates the financial impact to Hydro from unfavorable fluctuations in the price of No. 6 oil. Fluctuations in oil prices that result in oil costs that are higher than the cost per barrel as approved in the most recent cost of service on which rates are based, are deferred and collected from ratepayers through subsequent automatic rate adjustment.

Regulatory

Most rates that Hydro charges for the provision of electrical service are established by the PUB. In addition to approving the costs that can be recovered in rates, the PUB establishes the return that can be earned in Regulated Operations. This return is currently based on an ROE established at 4.47%, which is substantially lower than other electric utilities in Canada. Hydro has been unsuccessful in previous attempts to convince the PUB that a higher return from regulated activities was necessary. Management continues to believe that a return comparable to other electric utilities, commensurate with operational risk, is required in order to improve the financial performance of the regulated business and provide a fair return to the Shareholder. Management is in the process of preparing to again ask the PUB to address this issue at a future date.

SECTION 5: CRITICAL ACCOUNTING ESTIMATES

Hydro's discussion and analysis of its financial condition and results of operations are based on its Consolidated Financial Statements, which have been prepared in accordance with Canadian GAAP.

Significant accounting policies are contained in Note 1 to the Consolidated Financial Statements. Some of these policies involve critical accounting estimates requiring particularly subjective or complex judgments about matters that are inherently uncertain which could result in materially different amounts being under different conditions or using different assumptions. Management has discussed the development, selection, and application of its key accounting policies, and the critical accounting estimates and assumptions they involve, with the Audit Committee of the Board of Directors, and it has reviewed the disclosures described in this section.

The following section discusses the critical accounting estimates and assumptions that management has made and how they affect the amounts reported in the Consolidated Financial Statements. Hydro considers these estimates to be an important part of understanding the company's financial statements.

EMPLOYEE FUTURE BENEFITS

The company provides pensions and other retirement benefits for most of its employees. Hydro believes the accounting estimates related to Hydro's employee benefit plan costs are critical accounting estimates because: the amounts are based on complex actuarial calculations using several assumptions; and given the magnitude of the estimated costs, differences in actual results or changes in assumptions could materially affect Hydro's Consolidated Financial Statements.

Due to the long-term nature of these plans, the calculation of expenses and obligations depends on various assumptions such as discount rates, health care cost trend rates, projected salary increase, retirement age, mortality and termination rates. These assumptions are determined by management and are reviewed by Hydro's actuaries. The discount rate reflects the weighted average interest rate at which the other post-retirement liabilities could be effectively settled using high-quality bonds at the measurement date. Based on the employee demographics, and expected future benefit and medical claims, payments are measured and discounted to determine the present value of the expected future cash flows. The cash flows are discounted using yields on high-quality AA-rated non-callable bonds with cash flows of similar timing. Other assumptions are based on actual experience and best estimates.

Actual results that differ from the assumptions are accumulated and amortized over future periods and therefore generally affect recognized expense and the recorded obligation in future periods. These differences related primarily to actual actuarial gains/losses incurred on the benefit obligation versus those expected are recognized in the consolidated financial statements. For further details on the annual expense and obligation, see Note 10 to the Consolidated Financial Statements.

ASSET RETIREMENT OBLIGATIONS

Hydro recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of a fair value can be determined. Determining asset retirement obligations requires estimates in relation to the expected life of the asset, and the costs of demolition, dismantlement, restoration and remedial work that would be required.

SERVICE LIVES

Property, plant and equipment are amortized over their estimated service lives. Estimated service lives are determined based on the anticipated physical life of the asset, technological obsolescence, and past experience and are reviewed regularly to ensure that they continue to be appropriate.

IMPAIRMENT OF ASSETS

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted cash flows could be lower than the carrying value of the property and assets. In cases where the undiscounted future cash flows expected to be generated for the asset over its estimated useful life are less than the carrying amounts, an impairment loss is recognized equal to the amount by which the carrying amount exceed the fair value, or discounted cash flows.

Various assumptions and accounting estimates are required to determine whether an impairment loss should be recognized and if so, the value of such loss. The includes factors such as short-term and long-term forecasts of the future market price of electricity, the demand and supply of electricity, the in-service dates of new generating stations, inflation, fuel prices, capital expenditures and station lives. The amount of future net cash flow that Hydro expects to receive from its property, plant and equipment could differ materially from the net book values recorded in Hydro's Consolidated Financial Statements.

SECTION 6: FUTURE ACCOUNTING CHANGES

In January 2005, the Canadian Institute of Chartered Accounts (CICA) issued new guidance relating to comprehensive income, equity, financial instruments and hedges. Under the new standards a new statement for recognizing certain gains and losses - other comprehensive income - has been introduced, providing for certain gains and losses arising from changes in fair value to be temporarily recorded outside the income statement, but in a transparent manner; existing requirements for hedge accounting are extended; and all financial instruments, including derivatives, are to be included on a company's balance sheet and measured in most cases at fair value. The guidance will apply for interim and annual financial statements relating to fiscal years beginning on October 1, 2006. Management does not anticipate any major impacts on operations arising from the implementation of this new guidance.

SECTION 7: FORWARD–LOOKING STATEMENTS

Certain statements in this MD&A are forward-looking statements subject to risks and uncertainties. Statements containing words such as "could", "expect", "may", "anticipate", "believe", "intend", "estimate", "plan" and similar expressions constitute forward-looking statements. These statements are based on certain factors and assumptions including foreign exchange rates; expected growth, results of operations, performance, and business prospects and opportunities. While the company considers these factors and assumptions to be reasonable based on information currently available, they may prove to be incorrect. A number of factors could cause actual results to differ materially from those in the forward-looking statements, including, but not limited to: fluctuations in supply and demand in electricity markets; changes in capital markets; changes in currency and exchange rates; unexpected environmental conditions; and government or regulatory policy changes.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying Consolidated Financial Statements of Newfoundland and Labrador Hydro and all information in the Annual Report are the responsibility of Management and have been approved by the Board of Directors.

The Consolidated Financial Statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The Consolidated Financial Statements have been properly prepared within reasonable limits of materiality and in light of information available up to February 9, 2007. Financial information presented elsewhere in the Annual Report is consistent with that in the Consolidated Financial Statements.

Management maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities. An internal audit department independently evaluates the effectiveness of these internal controls on an ongoing basis, and reports its findings to Management and to the Audit Committee of the Board of Directors.

The responsibility of the external auditor, Deloitte & Touche LLP, is to express an independent opinion on whether the Consolidated Financial Statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditors' Report outlines the scope of their examination and their opinion.

The Board of Directors, through its Audit Committee, is responsible for ensuring that Management fulfills its responsibility for financial reporting and internal controls. The Audit Committee, comprised of independent directors, meets regularly with Management, the internal auditors and the external auditors to satisfy itself that each group has properly discharged its respective responsibility and to review the Consolidated Financial Statements and Management's Discussion and Analysis before recommending approval by the Board of Directors. The internal and external auditors have full and free access to the Audit Committee, with and without the presence of Management.

Edmund J. Martin
President and
Chief Executive Officer

Derrick F. Sturge
Vice-President, Finance and
Chief Financial Officer

AUDITORS' REPORT

To the **Lieutenant-Governor in Council**

Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 2006 and the consolidated statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these Consolidated Financial Statements present fairly, in all material respects, the financial position of the company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Deloitte & Touche LLP

Chartered Accountants

St. John's, Newfoundland and Labrador

Canada

February 9, 2007

CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2006**	2005
Assets		
Current assets		
Cash and cash equivalents	**10.0**	3.0
Short-term investments	**11.7**	6.1
Accounts receivable	**72.4**	67.9
Current portion of long-term receivable	**1.1**	1.1
Current portion of regulatory assets (Note 3)	**45.3**	41.8
Fuel and supplies	**54.4**	59.7
Prepaid expenses	**1.5**	2.3
	196.4	181.9
Property, plant and equipment (Note 2)	**1,791.5**	1,781.6
Long-term receivables (Note 4)	**19.2**	1.4
Sinking funds (Note 12)	**97.3**	85.8
Regulatory assets (Note 3)	**102.9**	145.5
Investments (Note 5)	**5.2**	5.2
Deferred charges (Note 7)	**3.5**	2.7
	2,216.0	2,204.1

See accompanying notes

CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2006**	2005
Liabilities and Shareholder's Equity		
Current liabilities		
Bank indebtedness	**6.5**	6.0
Accounts payable and accrued liabilities	**49.2**	59.0
Accrued interest	**30.8**	29.5
Current portion of long-term debt (Note 8)	**22.5**	222.6
Current portion of regulatory liabilities (Note 3)	**33.7**	1.3
Promissory notes (Note 8)	**58.8**	150.8
	201.5	469.2
Long-term debt (Note 8)	**1,378.4**	1,174.8
Regulatory liabilities (Note 3)	**16.6**	11.4
Long-term payable (Note 9)	**0.3**	0.7
Employee future benefits (Note 10)	**42.3**	38.5
	59.2	50.6
Non-controlling interest in Lower Churchill Development Corporation	**2.5**	2.5
Shareholder's equity (Note 11)		
Share capital	**22.5**	22.5
Contributed capital	**114.0**	114.0
Retained earnings	**437.9**	370.5
	574.4	507.0
Commitments and contingencies (Note 16)		
	2,216.0	2,204.1

See accompanying notes

On behalf of the Board:

Dean MacDonald
Director

Gerald J. Shortall
Director

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2006**	2005
Revenue		
Energy sales	**439.3**	453.9
Recovery of costs in rate stabilization plan (Note 3)	**83.6**	56.5
Guaranteed winter availability	**18.9**	16.4
Rentals and royalties	**0.3**	0.3
Other	**5.9**	5.4
	548.0	532.5
Expenses		
Operations and administration	**130.4**	130.8
Fuels	**71.0**	84.5
Amortization of costs in rate stabilization plan (Note 3)	**83.6**	56.5
Power purchased	**38.8**	35.9
Amortization	**48.5**	47.0
Interest (Note 13)	**105.7**	105.9
	478.0	460.6
Net income	**70.0**	71.9
Retained earnings, beginning of year	**370.5**	354.4
	440.5	426.3
Dividends	**2.6**	55.8
Retained earnings, end of year	**437.9**	370.5

See accompanying notes

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2006**	2005
Cash provided by (used in)		
Operating activities		
Net income	**70.0**	71.9
Adjusted for items not involving a cash flow		
Amortization	**48.5**	47.0
Amortization of deferred charges	**1.0**	1.0
Loss on disposal of property, plant and equipment	**1.6**	3.9
Foreign exchange gain	**-**	(0.1)
Other	**0.4**	0.2
	121.5	123.9
Change in non-cash balances (Note 14)	**55.4**	44.7
	176.9	168.6
Financing activities		
Long-term debt issued	**225.0**	-
Long-term debt retired	**(215.1)**	(32.4)
Foreign exchange loss recovered	**0.7**	1.5
Decrease in promissory notes	**(92.0)**	(7.0)
Dividends	**(2.6)**	(55.8)
	(84.0)	(93.7)
Investing activities		
Additions to property, plant and equipment	**(60.9)**	(47.7)
Proceeds on disposal of property, plant and equipment	**0.5**	0.4
Increase in sinking funds	**(18.5)**	(19.5)
Increase in short-term investments	**(5.6)**	(6.1)
Additions to deferred charges	**(1.9)**	(1.0)
	(86.4)	(73.9)
Net increase in cash	**6.5**	1.0
Cash position, beginning of year	**(3.0)**	(4.0)
Cash position, end of year	**3.5**	(3.0)
Cash position is represented by		
Cash and cash equivalents	**10.0**	3.0
Bank indebtedness	**(6.5)**	(6.0)
	3.5	(3.0)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**1.7**	0.3
Interest paid	**111.3**	111.9

See accompanying notes

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown Corporation and its principal activity is the development, generation and sale of electric power.

Gull Island Power Corporation Limited (GIPCo) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project). Lower Churchill Development Corporation Limited (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River (Lower Churchill Project). Both GIPCo and LCDC are inactive.

Churchill Falls (Labrador) Corporation Limited (CF(L)Co) is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW) CF(L)Co. Twin Falls Power Corporation Limited (TWINCo) is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974. Hydro and its subsidiary and jointly controlled companies, other than TWINCo, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles.

Preparation of these Consolidated Financial Statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, litigation, environmental and asset retirement obligations, and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

Rates and Regulations (excluding Sales by Subsidiaries)

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. As well, Hydro's borrowing and capital ex-

penditure programs are also subject to review and approval by the PUB. Rates are set through periodic General Rate Applications (GRA) utilizing a cost of service (COS) methodology. In December, 2006, the PUB approved interim rates effective January 1, 2007, reflecting an allowed rate of return on rate base of 7.4%. Final approval was granted by the PUB in April 2007. Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 3.

Principles of Consolidation

The Consolidated Financial Statements include the financial statements of Hydro and its subsidiary companies, GIPCo, (100% owned) and LCDC, (51% owned).

Effective June 18, 1999, Hydro, CF(L)Co and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co subsequent to the effective date of the shareholders' agreement.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

CF(L)Co holds 33.33% of the equity share capital of TWINCo and is a party with other shareholders in a participation agreement which gives CF(L)Co joint control of TWINCo. This investment is accounted for by the proportionate consolidation method.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. There were short-term investments of $11.7 million (2005 - $6.1 million) outstanding at December 31, 2006, bearing interest rates of 4.28% to 4.35% (2005 - 2.74% to 3.96%) per annum.

Fuel and Supplies

Fuel and supplies inventories are recorded at average cost.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that it is reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment, or the fair value of assets contributed. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment are amortized.

Hydro, GIPCo and LCDC

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Gains or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant

Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years

Transmission

Lines	40 and 50 years
Switching stations	40 years

Distribution System	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors, and generators, as well as water conveying and control structures, including dams, dykes, the tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kV. Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution. Distribution system assets include poles, transformers, insulators and conductors.

Other assets would include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

CF(L)Co

CF(L)Co uses the group amortization method for certain property, plant and equipment other than the generation plant, transmission and terminals and service facilities.

Amortization is provided on a straight-line basis over the following estimated useful lives:

Generation Plant

Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to amortization expense.

Impairment of Long-lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Promissory Notes

Promissory Notes bear interest from 4.25% to 4.55% per annum (2005 - 2.80% to 3.70%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB. Sales to Hydro-Québec and certain major industrial customers are at rates under the terms of applicable contracts.

A power contract with Hydro-Québec, dated May 12, 1969 (Power Contract) provides for the sale of substantially all the energy from CF(L)Co until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The base rate is predetermined in the Power Contract and decreases from the existing rate of 2.5425 mills per kilowatt hour (kWh) to 2.0 mills per kWh upon renewal in 2016.

CF(L)Co receives revenues from Hydro-Québec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of additional availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2005 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

(i) Under the provisions of the Power Contract CF(L)Co's exposure for a foreign exchange loss is limited. CF(L)Co recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 4).

Financial Instruments

As part of its risk management, Hydro may use derivative instruments in the form of interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense on an accrual basis. The company formally designates its hedges, documents and all hedging relationships and formally assesses hedge effectiveness. Derivative instruments designated as hedges in effective hedging relationships are accounted for using hedge accounting. In the event a hedging relationship is extinguished or the relationship is found to be ineffective, realized or unrealized gains or losses are recognized in the results of operations. For derivative instruments to which hedge accounting cannot be applied, realized and unrealized changes in fair value are charged to operations in the periods in which they occur. There were no interest rate swap agreements outstanding as at December 31, 2006.

Credit Risk

Hydro is exposed to credit risk associated with trade receivables. Although a significant portion of the total accounts receivable balance are due from one customer, management does not consider Hydro to be exposed to a material credit risk since that customer is another regulated utility.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 12 years.

Changes to Accounting Policies

In 2005, the CICA released Handbook sections 3855, 3865 and 1530, respectively entitled Financial Instruments - Recognition and Measurement, Hedges and Comprehensive Income.

Section 3855 specifies when a financial instrument should be accounted for on the balance sheet and at what amount: in some cases at fair value, while in other cases at a value based on cost. It also specifies how gains and losses on financial instruments should be presented.

Section 3865 replaces the guidance for hedging relationships that previously was included in Accounting Guideline 13, in particular the guidance for the designation and documentation of hedging relationships. These new recommendations specify how hedge accounting is applied and the required disclosures to be made by an entity applying hedge accounting.

Section 1530 establishes standards for the presentation and disclosure of comprehensive income. Comprehensive income for a reporting period includes, in addition to net income, the entire change in net assets attributable to transactions and other events from non-owner sources. Comprehensive income and its components will have to be presented in a financial statement with the same prominence as the other financial statements.

These sections will apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007. Hydro is currently examining the impact on its Consolidated Financial Statements of applying these new standards.

2. PROPERTY, PLANT AND EQUIPMENT

millions of dollars	Property Plant and Equipment in Service	Contributions In aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
			2006		
Generation Plant					
Hydroelectric	**1,362.0**	**20.5**	**300.8**	**70.4**	**1,111.1**
Thermal	**235.7**	**0.8**	**184.3**	**1.0**	**51.6**
Diesel	**59.7**	**6.1**	**27.9**	**1.0**	**26.7**
Transmission and Distribution	**753.0**	**60.8**	**213.9**	**2.3**	**480.6**
Service facilities	**22.0**	**-**	**10.8**	**-**	**11.2**
Other	**289.9**	**29.1**	**155.5**	**5.0**	**110.3**
	2,722.3	**117.3**	**893.2**	**79.7**	**1,791.5**
millions of dollars			2005		
Generation Plant					
Hydroelectric	1,358.8	20.5	289.1	54.8	1,104.0
Thermal	231.7	-	180.8	0.8	51.7
Diesel	58.5	6.3	26.0	0.1	26.3
Transmission and Distribution	734.2	55.1	197.8	2.2	483.5
Service facilities	22.0	-	10.4	-	11.6
Other	267.6	24.6	146.9	8.4	104.5
	2,672.8	106.5	851.0	66.3	1,781.6

Included in the above amounts are CF(L)Co assets in service amounting to $651.9 million (2005 - $641.9 million) which are pledged as collateral for long-term debt.

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods, that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities are no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations.

millions of dollars	**2006**	2005	Remaining Recovery Settlement Period (years)
Regulatory assets			
Long-term receivable	**63.1**	105.0	2
Rate Stabilization Plan	**-**	0.1	n/a
Foreign exchange losses	**75.5**	77.6	36
Deferred regulatory costs	**0.6**	0.7	3
Deferred major extraordinary repairs	**8.7**	3.8	5
Deferred study costs	**0.3**	0.1	3
Total regulatory assets	**148.2**	187.3	
Less current portion	**45.3**	41.8	
	102.9	145.5	
Regulatory liabilities			
Rate Stabilization Plan	**49.6**	11.9	n/a
Deferred purchased power savings	**0.7**	0.8	21
Total regulatory liabilities	**50.3**	12.7	
Less current portion	**33.7**	1.3	
	16.6	11.4	

Rate Stabilization Plan and Related Long-term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a Rate Stabilization Plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to December 31, 2003, have been converted to a long-term receivable which bears interest at the weighted average cost of capital and is to be recovered over a four-year period, which commenced in 2004. Any subsequent balances accumulating in the RSP including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of 25% of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2006, $3.9 million (2005 - $6.3 million) was deferred in the RSP.

Foreign Exchange Losses

The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses, be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 13).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 14 (2004), the PUB approved the deferral of external costs associated with the GRA and hearing, to be amortized over a three-year period, which commenced in 2004. In its 2006 GRA, Hydro sought and expects to receive approval for the deferral and amortization of external costs associated with that application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2006, $0.7 million (2005 - $0.7 million) of amortization was recognized in operations and administration expenses.

Deferred Major Extraordinary Repair

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station. This program is being carried out over a three-year period. Pursuant to

Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program will be recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the Holyrood plant. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the costs of the asbestos abatement program and the boiler tube repairs in the year in which they were incurred. In 2006, $1.1 million (2005 - $0.1 million) of amortization was recognized in operating costs.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. In its 2006 GRA, Hydro sought, and expects to receive, approval for recovery of these costs over a three-year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2006, $0.2 million (2005 - $0.1 million) was deferred in relation to studies.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. Since Hydro's AFUDC (7.6%) is lower that its cost of debt (8.0%), the amount

capitalized is lower and interest expense is higher by $0.3 million (2005 - $0.2 million) than that which would be permitted in the absence of rate regulation (Note 13).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

During 2005, pursuant to Order No. P.U. 7 (2002-2003) Hydro engaged an independent consultant to conduct a amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management estimates that accumulated amortization is approximately $170-180 million lower than it would otherwise be, and annual amortization expense is $10-11 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets.

4. LONG-TERM RECEIVABLES

Included in long-term receivables is a refundable deposit associated with an application for transmission service into Québec, which bears interest at prime, in the amount of $18.1 million (2005 - nil).

5. INVESTMENTS

millions of dollars	**2006**	2005
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

If LCDC is chosen as the ownership and financing vehicle for further development of the Lower Churchill Project, GIPCo's assets and the hydroelectric development rights to the lower Churchill River (Water Rights), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province (Option Agreement). The purchase price in respect of GIPCo's assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A

common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2007.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

6. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Hydro's proportionate share of CF(L)Co's assets and liabilities at December 31, 2006, and its proportionate interest in CF(L)Co's operations for the year ended December 31, 2006.

millions of dollars	**2006**	2005
Current assets	**44.0**	32.9
Long-term assets	**325.1**	331.8
Current liabilities	**24.8**	24.4
Long-term liabilities	**37.4**	51.7
Revenues	**70.6**	66.4
Expenses	**48.7**	48.6
Net income	**21.9**	17.8
Cash provided by (used in)		
Operating activities	**33.6**	32.1
Financing activities	**(19.8)**	(19.2)
Investing activities	**(10.1)**	(11.5)

7. DEFERRED CHARGES

millions of dollars	**2006**	2005
Debt discount, financing expenses and other	**16.7**	14.9
Accumulated amortization	**13.2**	12.2
Net deferred charges	**3.5**	2.7

8. LONG TERM DEBT

millions of dollars	**Hydro**	**CF(L)Co**	**Total**	Hydro	CF(L)Co	Total
		2006			2005	
Summary of long-term debt						
Long-term debt	**1,349.3**	**51.6**	**1,400.9**	1,331.5	65.9	1,397.4
Less current portion	**8.3**	**14.2**	**22.5**	208.4	14.2	222.6
	1,341.0	**37.4**	**1,378.4**	1,123.1	51.7	1,174.8

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2007	2008	2009	2010	2011
Sinking fund requirements	8.1	8.1	8.1	8.2	8.2
Long-term debt repayments	14.4	201.0	1.0	35.9	-
	22.5	209.1	9.1	44.1	8.2

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity		
millions of dollars				**2006**	2005
AC	5.05	2001	2006	**-**	200.0
AA	5.50	1998	2008	**200.0**	200.0
V (a)	10.50	1989	2014	**125.0**	125.0
X (a)	10.25	1992	2017	**150.0**	150.0
Y (a)	8.40	1996	2026	**300.0**	300.0
AB (a)	6.65	2001	2031	**300.0**	300.0
AD (a)	5.70	2003	2033	**125.0**	125.0
AE	4.30	2006	2016	**225.0**	-
Total debentures				**1,425.0**	1,400.0
Less sinking fund investments in own debentures				**76.2**	69.2
				1,348.8	1,330.8
Government of Canada loans at 5.25% to 5.63% maturing in 2006				**-**	0.1
Other				**0.5**	0.6
				1,349.3	1,331.5
Less current portion				**8.3**	208.4
				1,341.0	1,123.1

(a) Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

Hydro maintains a $50 million Canadian or U.S. equivalent unsecured operating credit facility with its banker. The facility is a requirement of Hydro's short-term promissory note program and is intended primarily to be a source of short-term funding in the event of disruptions in normal money market operations. Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance with interest calculated at the Prime Rate or prevailing Government BA Fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate.

CF(L)Co

millions of dollars	**2006**	2005
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $10.6; 2005 - U.S. $21.2)	**12.4**	24.8
7.875% Series B due December 15, 2007	**1.1**	2.2
General Mortgage Bonds		
7.500% due December 15, 2010	**38.1**	38.9
	51.6	65.9
Less current portion	**14.2**	14.2
	37.4	51.7

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund installments. There have been no contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments which commenced in June 1980. Each payment will be an amount equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date with a final principal payment of $35.9 million due in 2010. These bonds are subordinate to the First Mortgage Bonds.

Under the terms of long-term debt instruments, CF(L)Co may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999 places additional restrictions on dividends based on cash flow.

9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, arising from the difference between energy deliveries and the Annual Energy Base (AEB) pursuant to the Power Contract, bears an interest at 7.0% per annum and is repayable over a four-year period which commenced in September 2004. The current portion of $0.4 million (2005 - $0.4 million) is included in accounts payable and accrued liabilities.

10. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employers' contributions of $4.2 million (2005 - $4.1 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2006, cash payments to beneficiaries for its unfunded other employee future benefits was $2.4 million (2005 - $2.0 million). The most recent actuarial valuation was performed as at December 31, 2006.

millions of dollars	**2006**	2005
Accrued benefit obligation		
Balance at beginning of year	**49.0**	46.4
Current service cost	**2.0**	1.6
Interest cost	**3.0**	3.0
Actuarial loss	**16.2**	-
Benefits paid	**(2.4)**	(2.0)
Balance at end of year	**67.8**	49.0
Plan deficit at end of year	**67.8**	49.0
Unamortized actuarial loss	**(25.2)**	(10.2)
Unamortized past-service cost	**(0.3)**	(0.3)
Accrued benefit liability at end of year	**42.3**	38.5
Components of benefit cost		
Current service cost	**2.0**	1.6
Interest cost	**3.0**	3.0
Actuarial losses	**16.2**	-
	21.2	4.6
Adjustments		
Difference between actual actuarial loss and amount recognized	**(15.0)**	0.5
Benefit expense	**6.2**	5.1

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

millions of dollars	**2006**	2005
Discount rate	**5.3%**	6.3%
Rate of compensation increase	**3.5%**	3.5%

Assumed healthcare trend rates:

millions of dollars	**2006**	2005
Initial healthcare expense trend rate	**12.0%**	12.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2010**	2010

A 1% change in assumed healthcare trend rates would have had the following effects for 2006:

millions of dollars	**Increase**	Decrease
Current service cost	**0.2**	(0.2)
Interest cost	**0.5**	(0.3)
Accrued benefits obligation	**6.7**	(2.1)

11. SHAREHOLDERS' EQUITY

Share Capital

millions of dollars	**2006**	2005
Common shares of par value $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5

Contributed Capital

millions of dollars	**2006**	2005
Lower Churchill Development Corporation	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**96.4**	96.4
	114.0	114.0

12. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2006 and 2005 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

millions of dollars	Carrying Value	Fair Value	Carrying Value	Fair Value
	2006		2005	
Financial Assets				
Sinking funds	**97.3**	**113.6**	85.8	102.0
Long-term receivable including current portion	**20.3**	**20.3**	2.5	2.5
Financial Liabilities				
Long-term debt including current portion	**1,400.9**	**1,759.1**	1,397.4	1,783.8
Long-term payable including current portion	**0.7**	**0.8**	1.1	1.1

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2005 - 4.50% to 9.86%).

13. INTEREST EXPENSE

millions of dollars	**2006**	2005
Gross interest		
Long-term debt	**106.6**	108.3
Promissory notes	**5.1**	4.5
	111.7	112.8
Amortization of debt discount and financing expenses	**1.1**	1.0
Provision for foreign exchange losses	**2.1**	2.3
Foreign exchange gain	**-**	(0.1)
	114.9	116.0
Less		
Recovered from Hydro-Québec (a)	**1.1**	1.5
Interest capitalized during construction	**4.9**	4.3
Interest earned	**17.2**	18.7
Net interest expense	**91.7**	91.5
Debt guarantee fee	**14.0**	14.4
Net interest and guarantee fee	**105.7**	105.9

(a) Under the terms of the Power Contract, CF(L)Co recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

14. CHANGES IN NON-CASH BALANCES

millions of dollars	**2006**	2005
Accounts receivable	**(4.5)**	(0.7)
Fuel and supplies	**5.3**	(11.4)
Prepaid expenses	**0.8**	(0.3)
Accounts payable and accrued liabilities	**(9.8)**	10.8
Regulated assets	**39.1**	36.5
Regulated liabilities	**37.6**	6.4
Accrued interest	**1.3**	(0.8)
Employee future benefits	**3.8**	3.1
Long-term receivable	**(17.8)**	1.5
Long-term payable	**(0.4)**	(0.4)
	55.4	44.7

15. SEGMENT INFORMATION

Hydro operates in three business segments. Regulated operations encompass sales of power and energy to most customers within the Province of Newfoundland and Labrador while non-regulated operations are primarily engaged in energy project development and sales relative to markets outside the province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those described in Note 2.

	Regulated Operations	Non-Regulated Operations	Churchill Falls	Inter Segment Eliminations	Total
millions of dollars			**2006**		
Revenue - External customers	**416.5**	**57.4**	**70.6**		**548.0**
- Inter segment		**10.1**	**3.9**	**(10.5)**	
Amortization	**36.6**	**-**	**11.9**		**48.5**
Interest	**102.4**	**(1.3)**	**4.5**	**0.1**	**105.7**
Net income (loss)	**(6.9)**	**50.5**	**26.4**		**70.0**
Assets	**1,716.5**	**97.5**	**402.0**		**2,216.0**
Capital expenditures	**41.6**	**14.7**	**4.6**		**60.9**
millions of dollars			2005		
Revenue - External customers	408.7	54.3	66.4		532.5
- Inter segment		9.1	3.9	(9.9)	
Amortization	35.5	-	11.5		47.0
Interest	99.5	-	6.4		105.9
Net income	3.3	47.2	21.4		71.9
Assets	1,740.4	64.7	399.0		2,204.1
Capital expenditures	36.4	5.3	6.0		47.7

In 2006, sales to Hydro's two largest customers amounted to 61% and 14% of total revenue (2005 - 59% and 13%). At December 31, 2006 approximately 53.1% (2005 – 49.2%) of the total accounts receivable balance outstanding is due from one customer.

Geographic Information

Revenues by geographic area:

millions of dollars	**2006**	2005
Newfoundland and Labrador	**426.8**	413.7
Québec	**121.2**	118.8
	548.0	532.5

Substantially all of Hydro's assets are located in the Province.

16. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with TWINCo, expiring on December 31, 2014, CF(L)Co is required to deliver to TWINCo, at an agreed price, horsepower equivalent to the installed horsepower of the TWINCo plant and to maintain TWINCo's plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of TWINCo will revert to CF(L)Co, and CF(L)Co is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out in 2006, 2010 and every five years thereafter. The results of the 2006 monitoring are not yet available.

(b) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, CF(L)Co will commence the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to CF(L)Co's existing facilities and their replacement. CF(L)Co will acquire the permitted investments in six consecutive tranches during the 30-day period commencing on each of the following dates:

January 1, 2007	17.0 million
January 1, 2008	17.0 million
January 1, 2009	17.0 million
January 1, 2010	8.0 million
January 1, 2011	8.0 million
January 1, 2012	8.0 million

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced.

(c) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $1.4 million (2005 - $0.5 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $22.2 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(d) Outstanding commitments for capital projects total approximately $9.9 million at December 31, 2006 (2005 - $13.9 million).

(e) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	15 years
Hydroelectric	3 MW	1995	25 years
Hydroelectric	15 MW	1998	25 years
Hydroelectric	4 MW	1998	25 years
Hydroelectric	32 MW	2003	30 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years

Estimated payments due in each of the next 5 years are as follows:

millions of dollars	2007	2008	2009	2010	2011
Power Purchases	35.3	37.1	43.7	50.2	55.4

17. RELATED PARTY TRANSACTIONS

The Province, CF(L)Co, LCDC and GIPCo are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

(a) Hydro has entered into a long-term power contract with CF(L)Co for the purchase of $6.1 million (2005 -$6.1 million) of the power produced by CF(L)Co.

(b) Under an agreement between Hydro and CF(L)Co, Hydro provides certain engineering, technical, management and administrative services to CF(L)Co. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. For the year ended December 31, 2006 the fees paid to Hydro for these services amounted to approximately $1.9 million (2005 - $2.2 million).

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2006, Hydro paid $0.8 million (2005 - $0.7 million) to the PUB, including $0.4 million which was in accrued liabilities reflected at December 31 (2005 - nil).

(d) Under the terms and conditions of the CF(L)Co (Lease) Act, 1961, CF(L)Co must pay rentals and royalties to the Province annually.

18. COMPARATIVE FIGURES

Certain of the 2005 comparative figures have been reclassified to conform with the 2006 financial statement presentation.

FINANCIAL STATISTICS

Years ended December 31 (millions of dollars)	**2006**	2005	2004	2003	2002
Operating Results					
Revenue					
Energy sales	**439.3**	453.9	439.8	407.8	399.6
Rentals and royalties	**0.3**	0.3	0.3	0.3	0.3
Recovery of costs in RSP	**83.6**	56.5	34.2	16.7	14.0
Guaranteed winter availability	**18.9**	16.4	14.6	11.9	9.5
Other	**5.9**	5.4	4.6	4.8	4.2
	548.0	532.5	493.5	441.5	427.6
Expenses					
Operations and administration	**130.4**	130.8	123.4	125.8	125.8
Amortization of RSP costs	**83.6**	56.5	34.2	16.7	14.0
Fuels and power purchased	**109.8**	120.4	119.2	110.7	89.0
Amortization	**48.5**	47.0	45.8	45.0	43.0
Interest	**105.7**	105.9	103.7	99.3	97.8
	478.0	460.6	426.3	397.5	369.6
Income from operations	**70.0**	71.9	67.2	44.0	58.0
Write down of capital assets	**-**	-	-	130.9	-
Net income (loss) before non-controlling interest	**70.0**	71.9	67.2	(86.9)	58.0
Non-controlling interest	**-**	-	-	(12.3)	-
Net income (loss)	**70.0**	71.9	67.2	(74.6)	58.0
Contributions to net income (loss)					
Hydro	**43.6**	50.5	47.6	18.1	40.9
CFLCo	**26.4**	21.4	19.6	16.3	17.1
GIPCo	**-**	-	-	(96.3)	-
LCDC	**-**	-	-	(12.7)	-
Financial Position					
Total current assets	**196.4**	181.9	171.6	143.1	140.2
Total current liabilities	**201.5**	469.2	272.8	270.3	325.5
Net working capital	**(5.1)**	(287.3)	(102.0)	(128.0)	(186.2)
Property, plant and equip.	**2,684.7**	2,632.6	2,600.8	2,573.5	2,650.4
Accumulated depreciation	**893.2**	851.0	816.3	780.5	745.7
Property, plant and equip., net	**1,791.5**	1,781.6	1,784.5	1,793.0	1,904.7
Sinking funds	**97.3**	85.8	72.6	62.3	44.6
Other assets	**130.8**	154.8	187.9	225.1	225.7
Long-term debt	**1,378.4**	1,174.8	1,407.6	1,447.8	1,354.9
Other liabilities	**61.7**	53.1	45.3	35.3	45.3
Shareholder's equity	**574.4**	507.0	490.9	477.9	593.6
Staffing Levels					
Full-time equivalents	**1,147**	1,144	1,149	1,190	1,220

OPERATING STATISTICS

Years ended December 31	**2006**	2005	2004	2003	2002
Installed Generating Capacity *(rated MW)*					
CF(L)Co	**5,428**	5,428	5,428	5,428	5,428
TWINCo	**225**	225	225	225	225
Hydro					
Hydraulic	**939**	939	939	939	899
Thermal	**640**	640	640	640	640
Diesel	**56**	56	57	57	57
Total	**7,288**	7,288	7,289	7,289	7,249
Electric Energy Generated, Net *(GWh)*					
CF(L)Co	**34,663**	33,563	32,800	33,457	35,516
Hydro					
Hydraulic	**4,802**	4,770	4,726	4,321	3,986
Thermal	**729**	1,320	1,641	1,950	2,380
Diesel	**42**	43	46	45	48
Total	**40,236**	39,696	39,213	39,773	41,930
Electric Energy Sales *(GWh)*					
CF(L)Co					
Export	**29,835**	28,748	28,330	28,647	30,782
Hydro					
Utility	**4,617**	4,664	4,709	4,642	4,589
Rural	**834**	859	886	878	894
Industrial	**1,145**	1,685	1,842	1,711	1,675
Export	**1,483**	1,422	1,456	1,439	1,481
TwinCo Industrial	**1,801**	1,803	1,468	1,785	1,670
Total	**39,715**	39,181	38,691	39,102	41,091
Average Rate *(cents per kWh)*					
CF(L)Co					
Export	**0.25**	0.25	0.26	0.25	0.25
Hydro					
Utility	**5.24**	5.25	4.99	4.79	4.60
Rural	**6.13**	6.13	5.87	5.68	5.59
Industrial	**3.71**	3.43	3.24	3.14	3.08
Export	**3.55**	3.48	3.41	2.27	2.27
Transmission Lines *(km)*					
CF(L)Co					
735 kV	**608**	608	608	608	608
230 kV	**431**	431	431	431	431
Hydro					
230 kV	**1,608**	1,608	1,608	1,608	1,533
138 kV	**1,500**	1,500	1,500	1,500	1,533
69 kV	**634**	634	589	589	586
Total	**4,781**	4,781	4,736	4,736	4,691
Peak Demand *(MW)*					
CF(L)Co	**5,587**	5,608	5,645	5,615	5,587
Hydro System	**1,310**	1,361	1,405	1,402	1,403

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Chief Executive Officer

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Vice President
Business Development

Derrick Sturge
Vice President Finance and
Chief Financial Officer

Gilbert Bennett
Vice President
Lower Churchill Project

Gerard McDonald
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Human Resources and
Organizational Effectiveness

Andy MacNeill
Vice President and
General Manager CF(L)Co

John Mallam
Vice President
Engineering Services

Jim Haynes
Vice President
Regulated Operations

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Gilbert Bennett
Vice President
Lower Churchill Project
Newfoundland and Labrador Hydro

Jim Haynes
Vice President Regulated Operations
Newfoundland and Labrador Hydro

Ed Martin
President and Chief Executive Officer
Newfoundland and Labrador Hydro

Derrick Sturge
Vice President Finance and
Chief Financial Officer
Newfoundland and Labrador Hydro

LOWER CHURCHILL DEVELOPMENT CORPORATION LIMITED

Dean MacDonald (Chair)
President and Chief Executive Officer
Persona Inc.

Gilbert Bennett
Vice President
Lower Churchill Project
Newfoundland and Labrador Hydro

Ed Martin
President and Chief Executive Officer
Newfoundland and Labrador Hydro

Chris Padfield
Director, Renewable and
Electrical Energy Division
Natural Resources Canada

Derrick Sturge
Vice President Finance and
Chief Financial Officer
Newfoundland and Labrador Hydro

CORPORATE GOVERNANCE

Hydro's Board currently consists of ten directors, comprised of eight independent members drawn from the business community and the Deputy Minister, Natural Resources and the Corporation's President and CEO.

During 2006, the Board created a Corporate Governance Committee comprised of four independent directors. The Committee initiated a comprehensive review of the corporate governance practices of the Corporation. The objective of the review was to identify and implement best-practice corporate governance policies and processes.

The Board of Directors has four active committees all comprised of independent directors, including the Audit Committee, Corporate Governance Committee, Compensation Committee, and Safety, Health and Environment Committee. The corporate governance review resulted in new or revised mandates for the Board and the Committees.

In addition, the Board approved an auditor independence policy, a "whistle-blower" policy, and a code of business conduct and ethics. Implementation of the corporate governance changes will continue in 2007.

The Audit Committee is comprised of three independent directors. The Chair of the Committee is a retired partner of a national accounting firm with significant experience with the financial reporting requirements of large publicly traded companies. The major changes implemented by the Audit Committee during 2006 included the following:

- Enhancements to the quality of the Corporation's annual consolidated financial statements and MD&A.
- Implementation of a pre-approval process for non-audit services to be provided by the external auditor, including the identification of prohibited services.
- Approval of a policy regarding the hiring of current or former personnel of the external auditor in a financial reporting oversight role.
- Requirement that all members of the Audit Committee shall have basic financial literacy skills and at least one member shall have accounting expertise at a level comparable to the complexity of the Corporation's financial reporting issues.
- Procedures established for the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters (whistle-blower policy).
- An independent review initiated of the Corporation's internal audit department, which will be undertaken in 2007.

2006 INSTALLED GENERATING CAPACITY

THE HYDRO GROUP

CF(L)CO

LABRADOR

Interconnected MW

Hydraulic

Churchill Falls	5,428

HYDRO

LABRADOR

Interconnected

Thermal (Diesel) MW

Happy Valley	
Goose Bay	11.7
Mud Lake	0.1

Thermal (Gas Turbine)

Happy Valley	
Goose Bay	27.0

Rural Isolated

Thermal (Diesel) MW

15 Sites	22.8
Black Tickle	
Cartwright	
Charlottetown	
Hopedale	
L'Anse-au-Loup	
Makkovik	
Mary's Harbour	
Nain	
Norman Bay	
Paradise River	
Port Hope Simpson	
Postville	
Rigolet	
St. Lewis	
Williams Harbour	

ISLAND

Interconnected

Hydraulic	MW
Bay d' Espoir	604
Cat Arm	127
Upper Salmon	84
Granite Canal	40
Hinds Lake	75
Paradise River	8
Snooks Arm	0.6
Venams Bight	0.4
Roddickton	0.4
Thermal (Oil)	
Holyrood	490
Thermal (Gas Turbine)	
Hardwoods	54
Stephenville	54
Holyrood	15
Thermal (Diesel)	
Hawke's Bay	5
St. Anthony	9.7

Rural Isolated

Thermal (Diesel) MW

6 Sites	6.8
François	
Grey River	
Little Bay Islands	
McCallum	
Ramea	
St. Brendan's	

LEGEND

- Generating Station
- Terminal Station
- Diesel Plant
- Wind Generation

Transmission Lines

- 715-kV
- 230-kV
- 138-kV
- 69-kV
- Low Voltage
- Customer-Owned

2006 GROSS ISLAND INTERCONNECTED ENERGY SUPPLY

Hydraulic Generation	GWh
Bay d' Espoir	2,814
Cat Arm	799
Upper Salmon	570
Hinds Lake	345
Granite Canal	247
Paradise River	37
Mini Hydro	6
	4,817
Percentage of Total Energy Supply	79%

Power Purchases	44%
Percentage of Total Energy Supply	7%
Thermal Generation	
Holyrood	799
Gas Turbine and Diesel	2
	1,250
Percentage of Total Energy Supply	13%

HYDRO
THE POWER OF COMMITMENT

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